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THE WHITE HOUSE
WASHINGTON

CABINET AFFAIRS STAFFING MEMORANDUM

Date: 2/14/84 **Number:** 168906CA **Due By:** ______

Subject: CCFA and CCCT with the President - Thursday, February 16, 1984
2:00 p.m. - Cabinet Room

	Action	FYI
ALL CABINET MEMBERS	☐	☐
Vice President	☑	☐
State	☑	☐
Treasury	☑	☐
Defense	☐	☑
Attorney General	☑	☐
Interior	☑	☐
Agriculture	☑	☐
Commerce	☑	☐
Labor	☑	☐
HHS	☐	☑
HUD	☐	☑
Transportation	☑	☐
Energy	☑	☐
Education	☐	☑
Counsellor	☑	☐
OMB	☑	☐
CIA	☐	☑
UN	☐	☑
USTR	☑	☐
GSA	☐	☐
EPA	☐	☐
OPM	☐	☐
VA	☐	☐
SBA	☐	☐

	Action	FYI
CEA	☑	☐
CEQ	☐	☐
OSTP	☐	☐
Baker	☑	☐
Deaver	☐	☑
Darman *(For WH Staffing)*	☑	☐
Jenkins	☐	☑
Mc Farlane	☐	☑
Svahn	☑	☐
CCCT/Gunn	☑	☐
CCEA/Porter	☐	☐
CCFA/	☑	☐
CCHR/Simmons	☐	☐
CCLP/Uhlmann	☐	☐
CCMA/Bledsoe	☐	☐
CCNRE/	☐	☐

REMARKS:

The President will chair a joint meeting of the Cabinet Council on Food and Agriculture and the Cabinet Council on Commerce and Trade on Thursday, February 16, 1984 at 2:00 p.m. The meeting will be held in the Cabinet Room. The agenda is as follows:

Farm Sector Conditions and Program Review/CM#453	(paper attached)
Wine Equity Act of 1983/CM#440	(paper attached)
U.S. Poultry and Egg Industry/CM#439	(paper attached)
Alaskan Oil Exports/CM#420	(paper to be distributed on 2/15/84)

RETURN TO:

☐ Craig L. Fuller
Assistant to the President
for Cabinet Affairs
456-2823

☐ Katherine Anderson ☐ Don Clarey
☐ Tom Gibson ☑ Larry Herbolsheimer
Associate Director
Office of Cabinet Affairs
456-2800

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CM453

THE WHITE HOUSE

WASHINGTON

January 19, 1984

MEMORANDUM FOR THE CABINET COUNCIL ON FOOD AND AGRICULTURE

FROM: JOHN R. BLOCK, CHAIRMAN PRO TEMPORE

SUBJECT: Farm Sector Conditions and Program Review

Overview

The payment-in-kind (PIK) program and the drought have reduced exessive supplies; and as a result, farm income will be increasing through 1984. We now have an opportunity to evaluate current farm policies and prepare for market-oriented programs to be implemented with the 1985 Farm Bill. However, accomplishing this objective will require a well-coordinated effort throughout the Administration. That coordinated effort must begin with an appreciation of the forces which have shaped agriculture in recent years.

Abundance and Economic Stagnation Yield Surpluses and Increasing Government Costs

Following the 1980 drought, U.S. farmers responded by planting much of their acreage. The weather cooperated and we had successive record harvests in 1981 and 1982. In just 10 years, production had jumped more than a third. Total acreage planted to major crops increased in the 1970s as demand for U.S. farm products rose and exports surged. Crop yields also increased and helped boost production.

Record production was not matched by similar increases in demand. The recession weakened domestic demand for agricultural products, particularly livestock products and raw materials. Three years of generally good weather worldwide reduced export demand for U.S. agricultural products, and strong competition from other suppliers hurt the U.S. export share as the total export market shrank. Global recession weakened income growth and demand. A dramatic slowing of capital and credit flows, together with the worldwide economic recession, left many nations in precarious cashflow and foreign exchange positions. Sharply higher interest rates not only slowed investment and demand but also increased the costs of holding commodity inventories above working needs. The higher value of the U.S. dollar made our agricultural products much more costly to foreign buyers.

With foreign demand falling, we found ourselves in late 1982 with burdensome stocks of grains, oilseeds and cotton relative to

current and near-term prospective demand. Prices of these commodities were low, and in real terms farm income was dropping. Low prices and incomes caught many farmers in a severe cashflow bind, especially those who were heavily leveraged. The number of debt repayment delinquencies, bankruptcies, and foreclosures rose sharply. The demand for land slackened, leading in 1982 to the first decline in land values in more than twenty years. Declining land values reduced the equity position of farmers, thus reducing their ability to continue to borrow. Farmers' purchases of goods and services from the nonfarm sector declined, leading to financial difficulties for farm suppliers, rural merchants and businesses, and rural governments.

This was not the economic environment envisioned when the 1981 Farm Bill was developed. Thus, the commodity programs mandated by the 1981 Farm Bill quickly became part of the problem. Target prices for the major program commodities escalated between 4 to 5 percent per year while production costs stabilized or declined. The resulting spread between sagging market prices and the escalating targets was not only increasing the incentives to produce but also increasing budget exposure dramatically.

The problems were not confined to the grains sector. Surpluses and budget problems were plaguing the dairy industry; yet producers and their leaders continued to resist changes in the basic dairy program. With the basic dairy support price well above market clearing levels, declining feed costs, coupled with continued improvements in output per cow, were further aggravating the problem of surplus milk supplies. The Federal Government was required to purchase more and more dairy products to support the excessive dairy price support levels with annual costs in excess of $2 billion.

As a result of all this, total budget outlays by the Commodity Credit Corporation (CCC) soared. Net CCC outlays, which had totaled $4 billion in FY 81, reached nearly $12 billion in FY 82. Indications were that FY 83 outlays could exceed $20 billion. If actions were not taken soon to reduce the building surpluses, the prospects suggested budget outlays of $10 to $13 billion per year for the 1984-86 period.

<u>The Payment-In-Kind (PIK) Program - Realization of Objectives</u>

The first challenge was to take action to sharply reduce potential production and burdensome stocks, increase commodity prices and farm income, and reduce budget outlays, while preserving the natural resources that agriculture depends on for future years. On January 11, 1983, the President announced the largest acreage adjustment program in history. The PIK program has not been without its critics. However, an objective assessment must be based on the program's ability to achieve its goals. The record speaks for itself.

	U.S. Ending Stocks		Farm Prices[1]	
	1982/83	Projected 1983/84	Dec.1982	Dec.1983
Corn (mil. bushels)	3,140	595	$2.26	$3.14
Wheat "	1,509	1,441	$3.51	$3.46
Soybeans "	387	185	$5.46	$7.61
Cotton (mil. bales)	7.9	3.6	57.3¢	67.3¢
Rice (mil. cwt.)	71.5	36.9	$8.06	$8.67

1/ Farm prices are $ per bushel for wheat, corn and soybeans; cents per pound for cotton and $ per hundredweight for rice.

	1981	1982	1983	1984 (Projected)
Net Farm Income (bil. $)	30	22	22-24	29-34
Acreage in Conservation Use (mil. acres)	-	11	77	18-22
CCC Budget Outlays (bil. $)	4.0	11.6	18.8[1]	6.7

1/ This estimate does not include the book value of commodities distributed under the PIK program, which was approximately $9 billion. The outlays on these commodites were made in prior years. The loss to the Treasury is reduced potential receipts if the commodites could have been sold into the market.

While adverse weather enhanced the effectiveness of the PIK program in achieving its objectives over a shorter time frame, this does not detract from the basic success of the program. With the exception of wheat, the program has contributed to significant reductions in carryover stocks, increased prices and incomes, record acreages under conservation use, and sharply lower CCC budget outlays. And with wheat it kept the surplus from growing over 2 billion bushels.

The cost of the PIK program probably has received greater attention than any of the administrative or legal issues arising from the implementation of the program. However, the issue of costs must be dealt with in the context of the supply-demand imbalance that existed at the time of the decision to implement the PIK program.

By late 1982 it was clear that without a massive acreage reduction program, the Government was going to be taking ownership of record large quantities of commodities for which loans had already been made to farmers. Market prices were not expected to be strong enough to prevent this from happening. Moreover, the chances of market prices rising high enough to allow the Government to legally sell the commodities back on the market or to trigger release of the farmer-owned reserve were slim to none -- barring some unforeseen surge in world demand or poor weather. Thus, all the carrying costs of these record surpluses, such as storage and interest, would have been borne by the Government for a very long period of time. For example, the carrying costs per bushel of corn for just three years approached about $1.50 per bushel--about one-half of the market value. The PIK program resulted in savings of $3 billion in carrying costs to CCC through FY 1986.

More importantly, the PIK program -- with the help of the drought -- has brought a turnaround in farm prices and the farm economy. Since the implementation of PIK, farm prices for corn have increased nearly 40 percent, cotton prices are up nearly 20 percent, and rice prices have increased around 8 percent. Wheat prices are averaging near to slightly below year earlier levels. Over the FY 83-86 period, income support (deficiency) payments are expected to be reduced by over $3.5 billion as a result of higher market prices generated by the PIK program. Moreover, over $3 billion more will be saved by lower disaster and diversion payments.

The PIK program, after adding PIK acquisition costs, is expected to reduce total Government outlays for commodity programs by about $9 billion in the period FY 1983 through FY 1986.

However, the PIK program was not without costs. The Government has given up assets (commodities) with a book value of about $9 billion that sometime in the future might have been sold back on the market with attendant reductions in Treasury borrowing. No one knows when this could have occurred legally or politically (farmers do not appreciate the Government selling commodities back on the market and depressing their prices) without a substantial reduction in production. Even if the stocks were sold, such massive sales would have depressed market prices and ultimately increased the cost of farm programs.

A related issue is the large dollar value of commodities received by individual producers. But the issue should not be whether these producers were entitled to such large payments. They were compensated in commodities for reducing acres in the same manner as every other producer -- large or small. It may be more appropriate to ask whether it is possible to have effective acreage adjustment programs without making large payments to individual farm units. Perhaps the increasing concentration of agriculture production has eroded the effectiveness of any acreage adjustment programs.

PIK was a temporary adjustment mechanism which did nothing to fundamentally change the factors that led to the large surpluses. The second challenge was to adjust the Government program incentives that were encouraging more production than the marketplace needed. It would be necessary to stop the escalation in target prices and to lower price support levels if agricultural production was to be responsive to market conditions. With respect to the dairy price support, it was clear that it was critical to reduce the incentives for producing milk by lowering price supports.

While we were able to exercise our authority to reduce feed grains and wheat loan levels, we were not successful in getting Congress to freeze target prices. All of our legislative efforts to move the issue to a vote in the Congress were blocked by a minority in the Senate. Nevertheless, target price freeze legislation was the subject of extensive debate and discussion, and it served to focus public attention on the need to make adjustments in farm price support programs.

With respect to dairy legislation, we did not achieve everything for which we had hoped. However, the new dairy legislation will provide the first reduction in dairy price supports since 1962 and will lay the foundation for the type of flexibility that is essential in keeping farm programs in line with market developments. The dairy diversion program will be difficult to administer, but at the end of the 15-month period we will have price supports as much as $1.50 per hundredweight lower than a year earlier.

A Look to 1984-85 Economic Conditions in the Farm Sector

It seems that 1984 will be a year of further adjustments. Stronger crop prices and more modest programs with less participation most likely will lead to substantially larger seedings in 1984. Most of the acreage removed from production in 1983 will be back in production this year. Corn and cotton acreage could go up 40 percent while seedings of wheat and soybeans could rise 10 to 15 percent. Production, of course, will be influenced by weather conditions in the months ahead. With generally fair conditions, crop production will surge and likely exceed the expected slow increase in use. Foreign output likely also will rise again in response to last year's higher prices.

With the exception of wheat, carryover stocks will be pulled down sharply by the time 1984 harvests begin. Corn and soybean stocks could approach pipeline levels by next fall. So it is desirable for crop production to increase enough in 1984 to allow modest stock building of corn and soybeans.

Prospects are poor for grains in domestic and foreign use in 1984. Economies in most countries will be recovering moderately, and this should help bolster demand for U.S. farm products.

However, the dollar remains strong, and the major problems facing many developing countries will not disappear. Thus, we can expect only moderate growth in the value of U.S. exports. Export volume in 1983/84 is expected to be lower.

Domestic demand should pick up along with the increase in business activity and the decline in unemployment. This should help the demand for food and fiber. However, meat supplies will remain large in early 1984, and there will be little incentive for livestock feeders to increase production, although poultry production will probably expand. This should result in a steady but limited increase in livestock prices through much of 1984.

With lackluster demand, any large increase in crop production this year likely will be reflected in sharp increases in carryover stocks and declining farm prices in late summer and early fall. Ideal weather likely would boost stocks to burdensome levels.

While consumers may continue to enjoy only moderate increases in food prices, farmers will be faced with lower farm incomes in 1985 unless a combination of weather problems here and abroad or faster increases in general economic activity come to the rescue by the middle of next year.

Policy Outlook Through 1985

It is likely that U.S. agricultural programs through 1985 will be determined by the provisions of the 1981 Agriculture and Food Act and the 1982 Omnibus Budget Reconciliation Act. This legislation establishes minimum target prices for:

	1983	1984	1985
Corn ($/bu)	2.86	3.03	3.18
Wheat ($/bu)	4.30	4.45	4.65
Cotton ($/lb)	.76	.81	.86
Rice ($/cwt)	11.40	11.90	12.40

This legislation allows the Secretary to establish higher target prices based on changes in per acre production costs.

The minimum established loan rates and dairy support price are:

		1983	1984	1985
Corn	($/bu)	2.65	2.55	2.30
Wheat	($/bu)	3.65	3.30	3.30
Cotton	($/lb)	.55	.55	.55
Rice	($/cwt)	8.14	8.00	8.00
Soybeans	($/bu)	5.02	5.02	5.02
Dairy	($/cwt)	13.10/12.60	12.60	12.60/12.10/11.60

Current law limits the Secretary's flexibility to adjust farm programs to the current economic environment. For example, we have made great strides in reducing the rate of inflation and the rate of increase in costs of farm inputs. As a result, the legislated increases in commodity target prices have greatly exceeded the rate of increase in production costs for nearly all commodities since 1981. Yet, without a change in the law, the target prices for most agricultural commodities will continue to escalate. We will continue to seek new legislation in the coming year that would reduce the rate of increase in target prices. We believe this is necessary, because without such a change we are faced with an annual potential budget exposure of over $10 billion for farm commodity programs beyond fiscal 1984.

Planning for the Future of Food and Agriculture Programs

Authority for most Federal agriculture and related programs expires at the end of the 1985 crop year. Without enactment of new legislation, the Secretary of Agriculture will have to implement the rigid and obsolete farm legislation of the past, something that the Administration and virtually all interest groups will want to avoid. In addition to the expiration of farm legislation, the economic difficulties of the farm community and the large budget outlays for agriculture programs over the last two years have attracted unparalleled public scrutiny of agricultral polices and programs. This scrutiny will increase as Congress begins to consider new farm legislation in 1984 and 1985.

On January 5, 1984, the President announced to a group of farm leaders that he was charging the Cabinet Council on Food and Agriculture to conduct a comprehensive review and assessment of current food and agriculture programs. The President indicated that the purpose of this endeavor is to better prepare the Administration to participate in the debate on the future of Federal farm programs. The President emphasized that his Administration would be seeking information and ideas from people inside and outside of government during this comprehensive review and assessment.

In order to carry out the President's directive and to maintain the Administration's leadership role in the debate on farm programs, a Cabinet Council on Food and Agriculture working group has been established to:

- review and assess current food and farm programs;
- initiate a dialogue on the future course of food and agriculture policy with interested parties outside the Administration;
- devise a list of food and agriculture policy options;

- make recommendations to the Cabinet Council regarding the components of the Administration's 1985 Farm Bill.

The working group is called the Working Group on Future Food and Agriculture Policy and consists of representatives at the assistant secretary level or above from the Departments of Agriculture, State, Treasury, and Commerce, the Office of the U.S. Trade Representative, the Office of Management and Budget, the Council of Economic Advisors, and the White House Office of Policy Development. The Deputy Secretary of Agriculture will serve as the chairman of the Working Group. The Executive Secretary of the Cabinet Council will serve as the executive director of the Working Group.

U.S. FARM POLICY

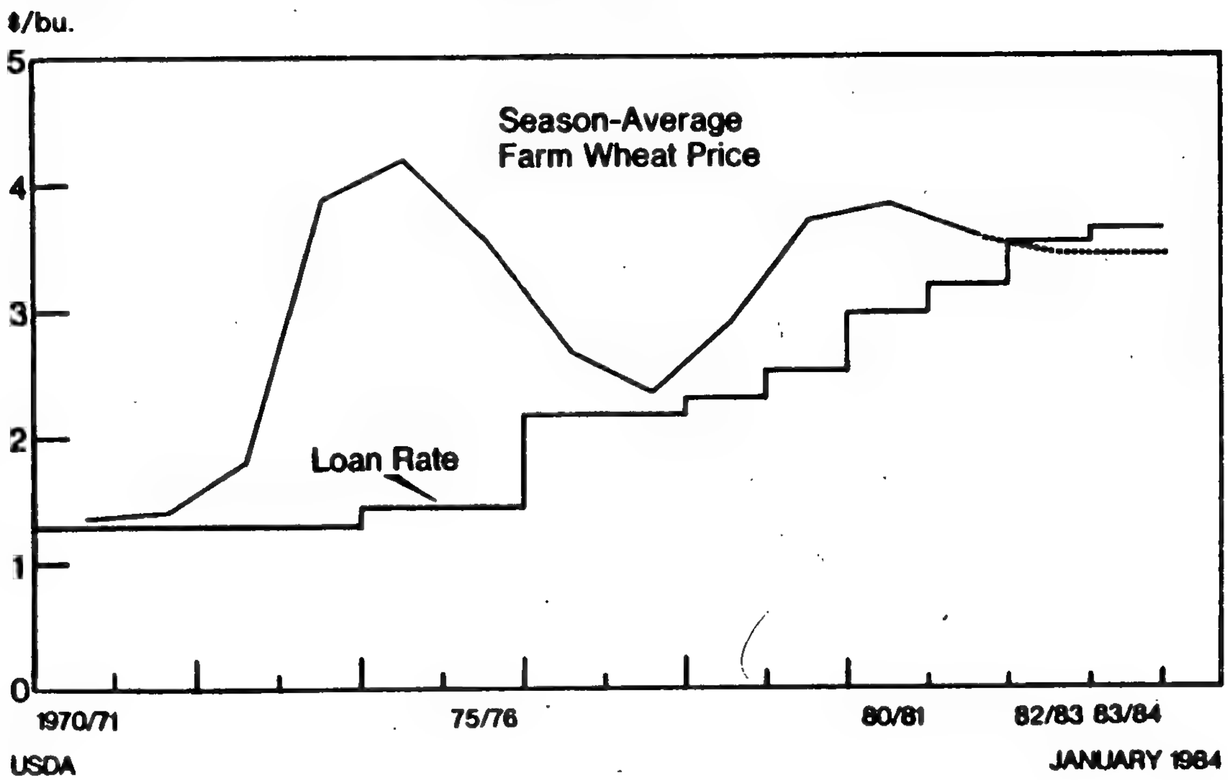
1980 - 1983

WHAT HAPPENED?

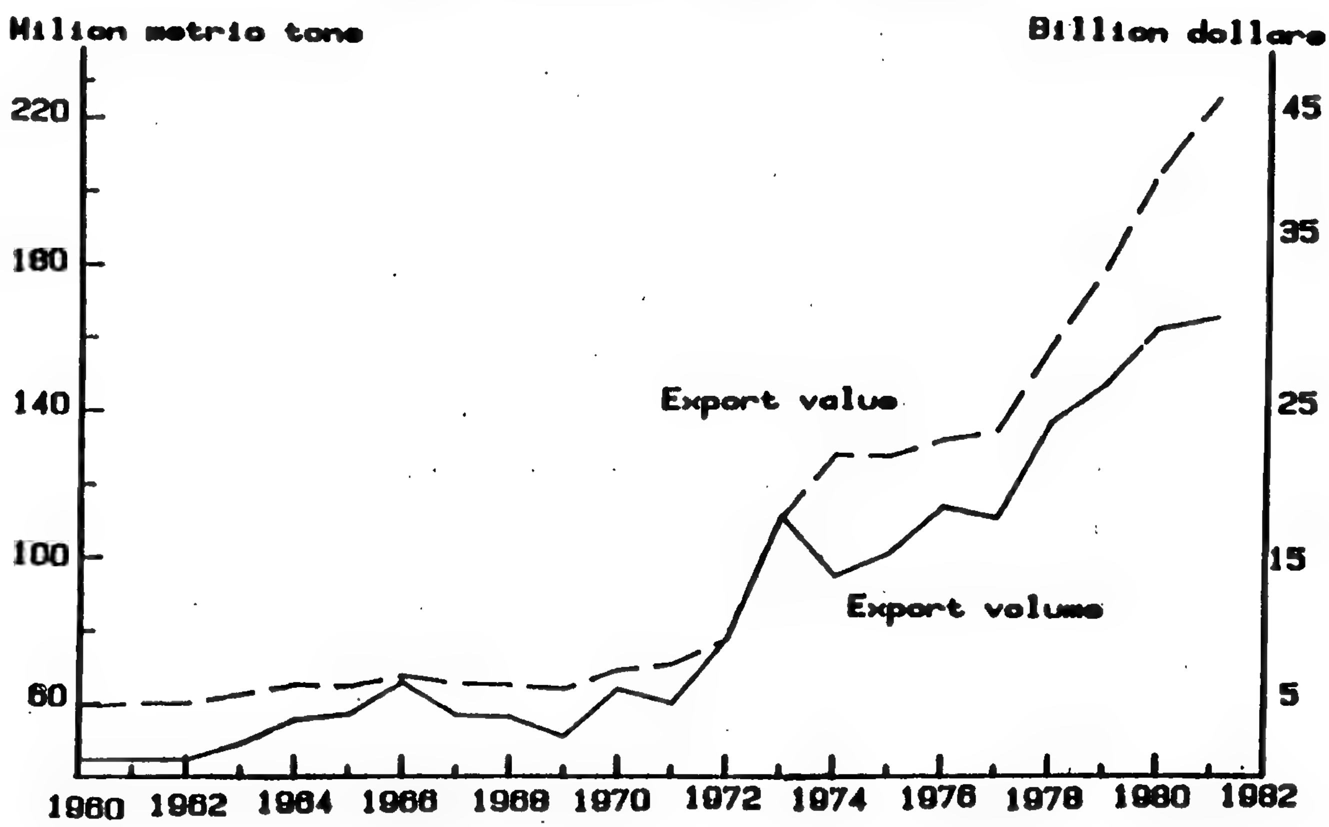
MANY FACTORS PROPELLED PRODUCTION UPWARD OVER THE PAST DECADE:

- **RISING PRICES AND PRICE SUPPORTS**
- **BOOMING FARM EXPORTS**
- **ACREAGE EXPANSION**
- **FAVORABLE WEATHER AND IMPROVED TECHNOLOGY BOOSTED YIELDS**

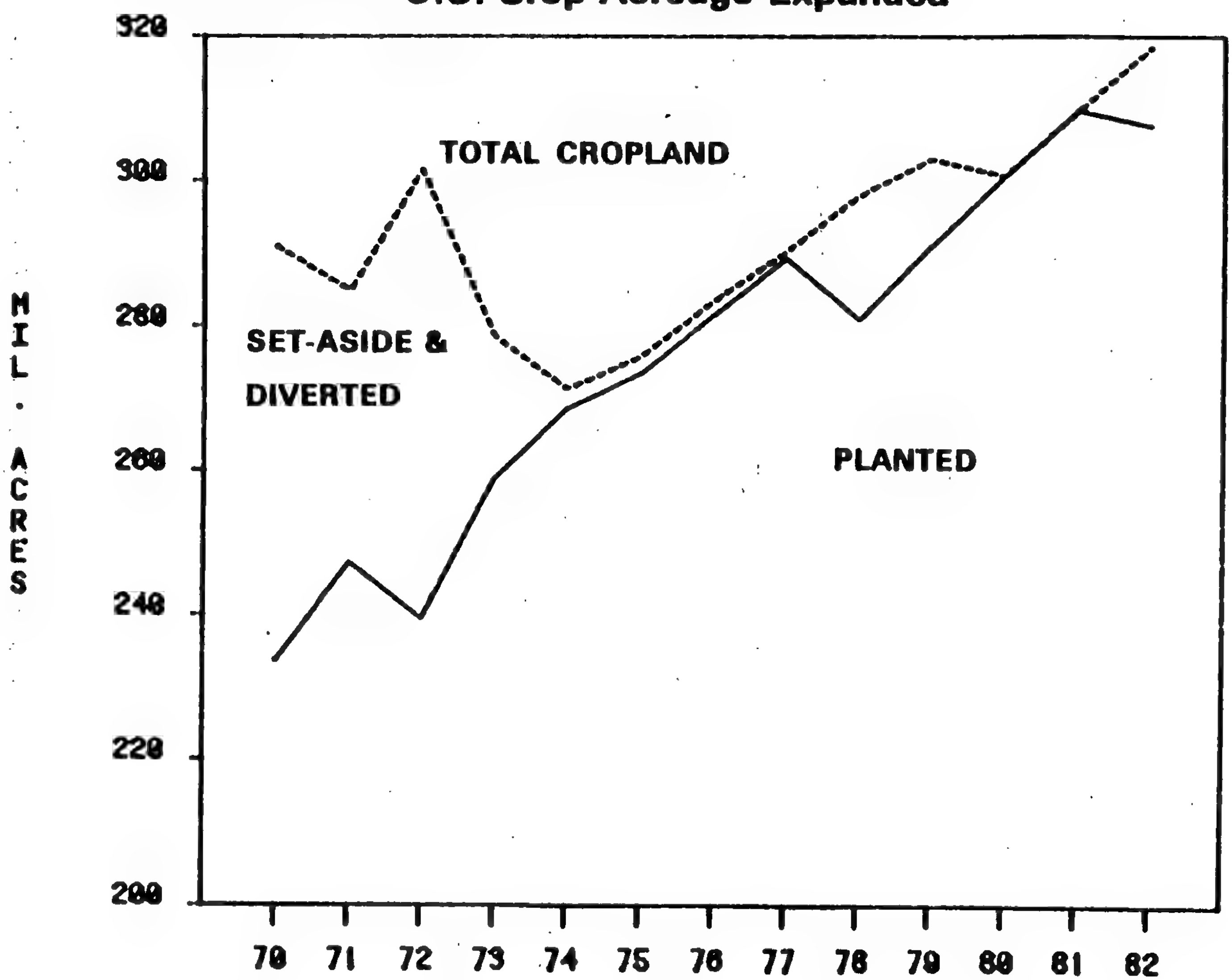
Prices and Loan Rates Trended Upward



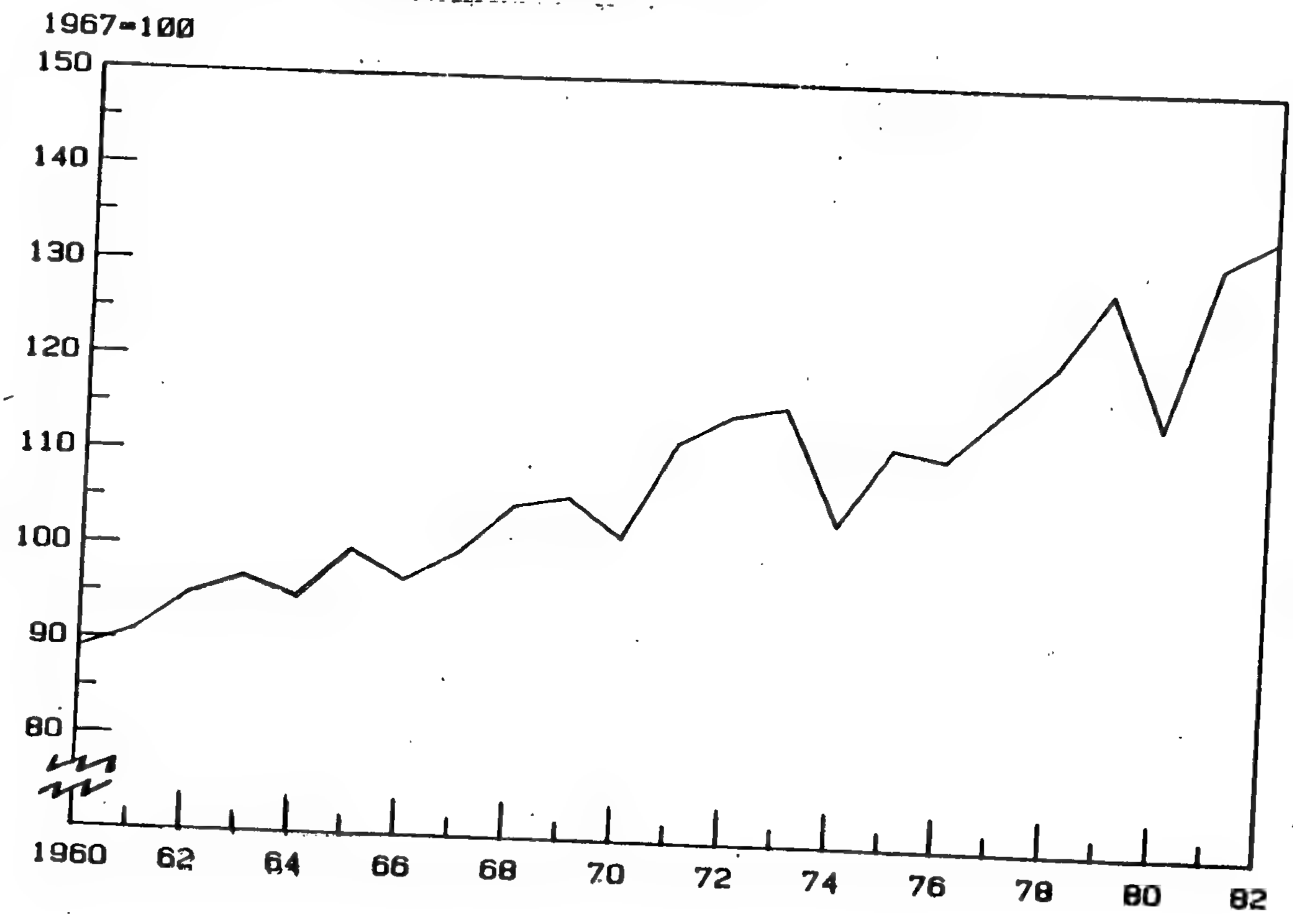
Agricultural Exports Soared



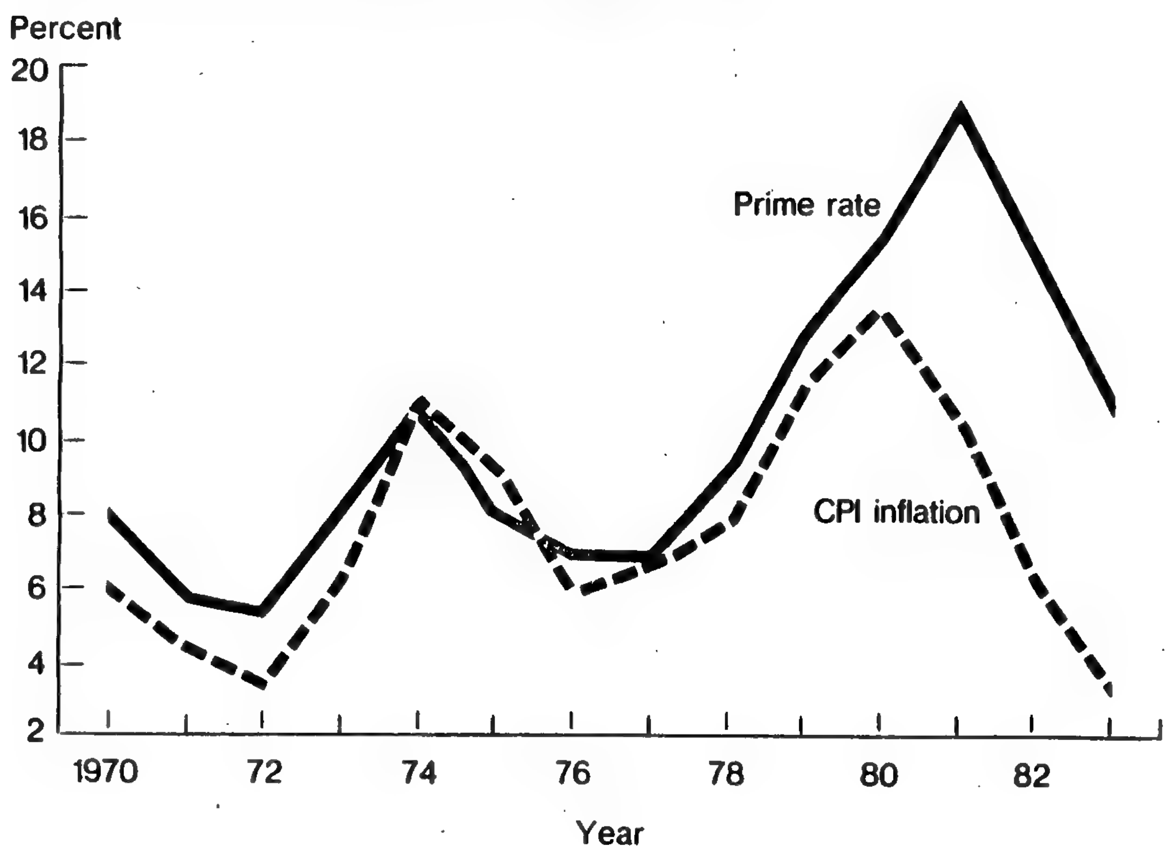
U.S. Crop Acreage Expanded



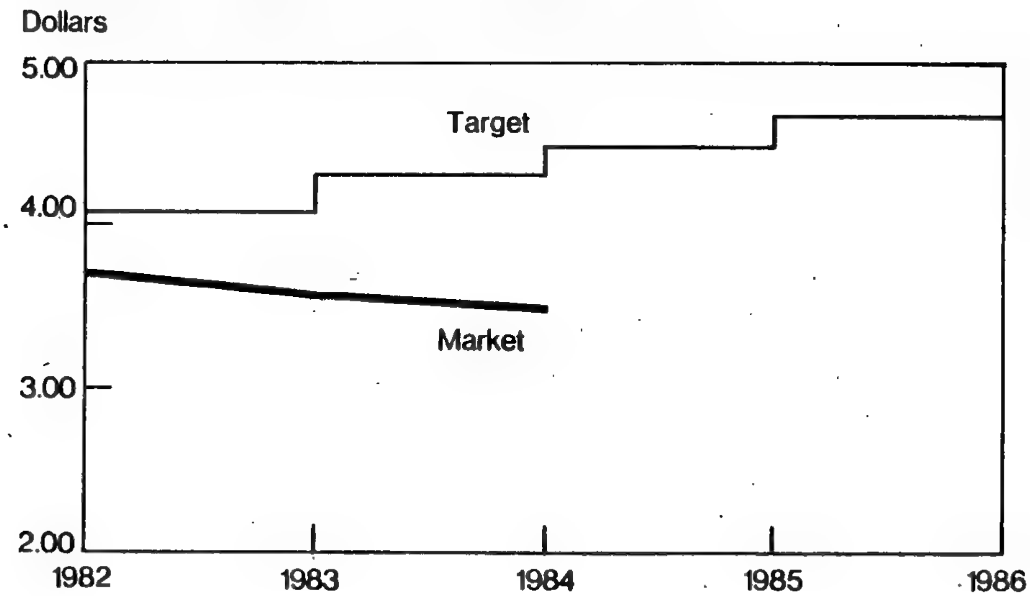
Favorable Weather and Improved Technology Boosted Yield Per Acre



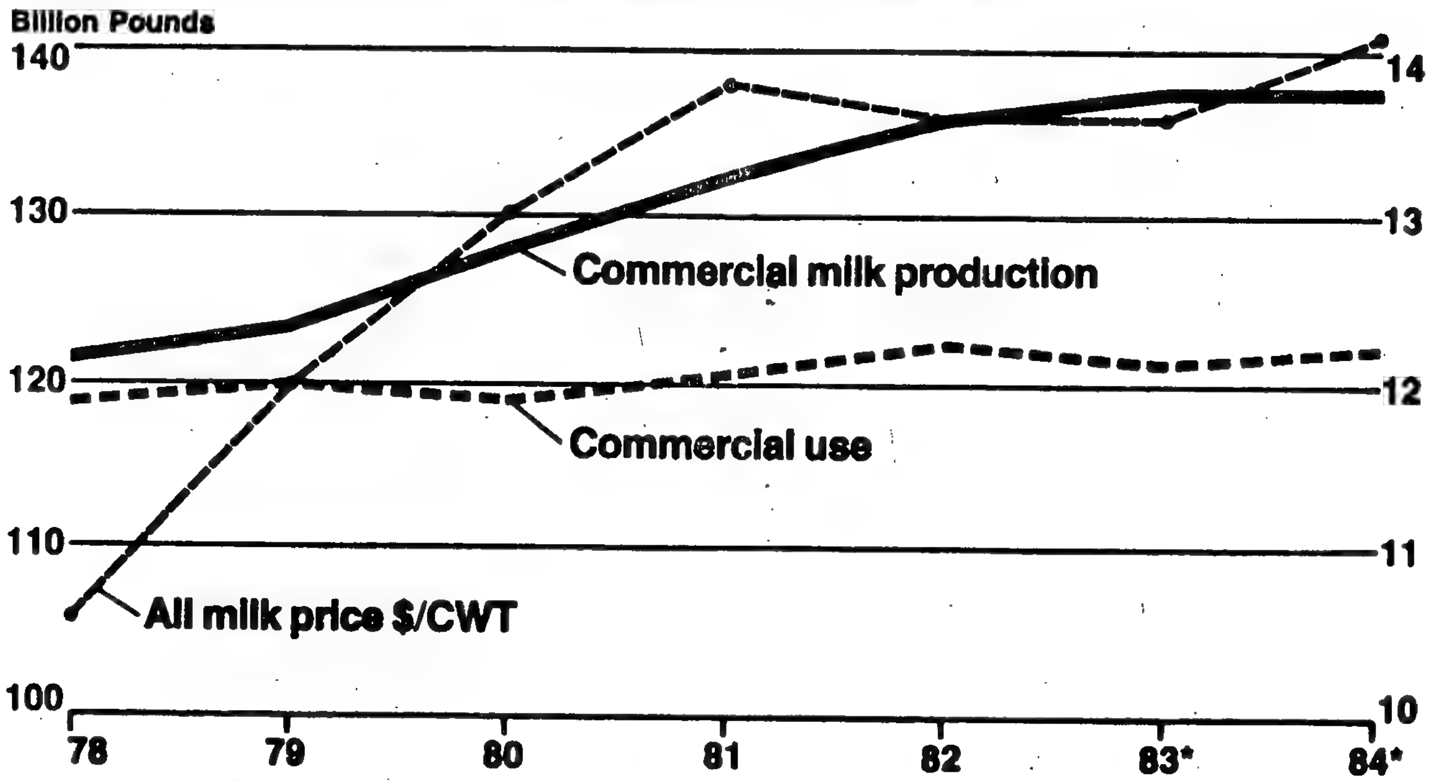
Prime Interest Rate vs. CPI Inflation Rate



Wheat Target Prices-1981 Act



Milk Production, Use and Prices

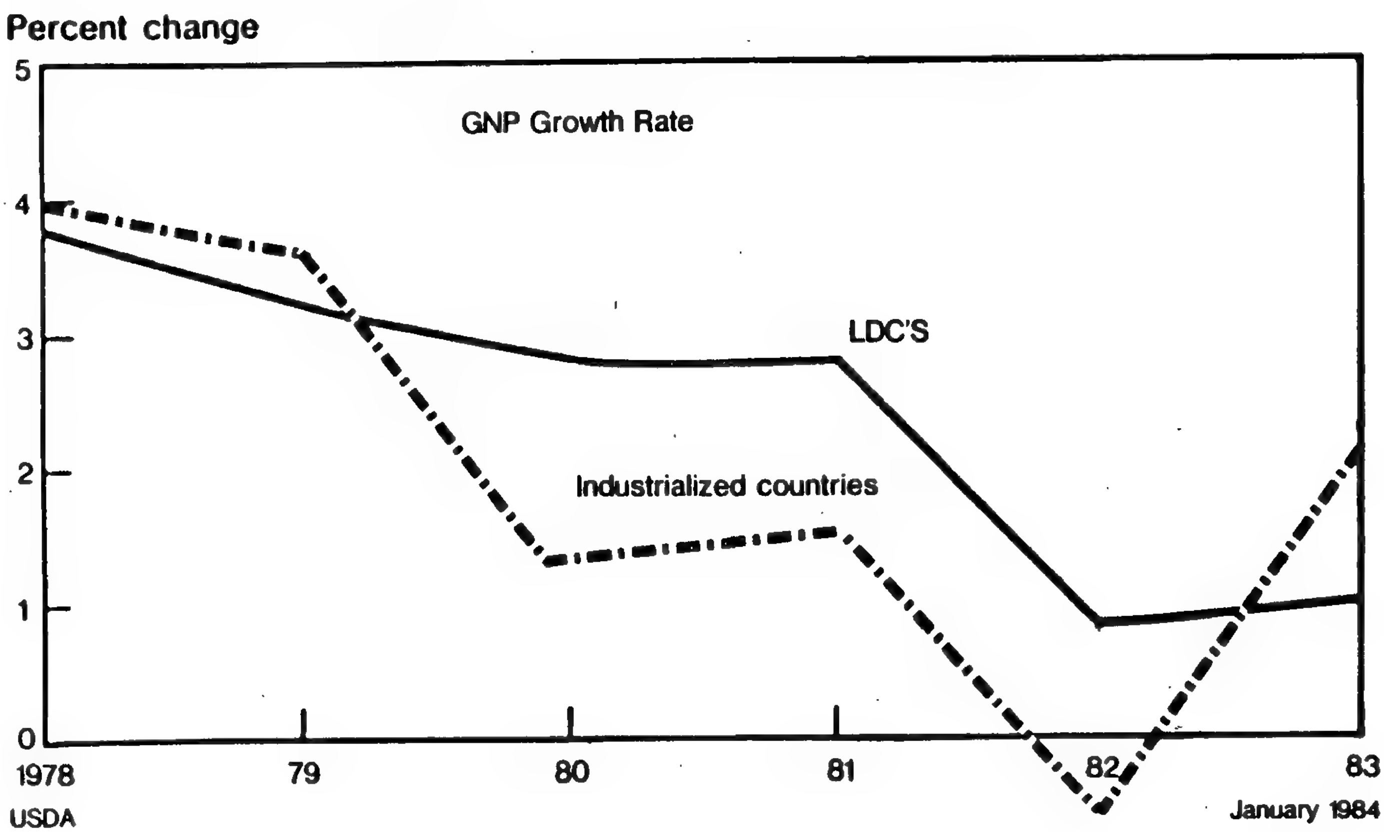


*Forecast

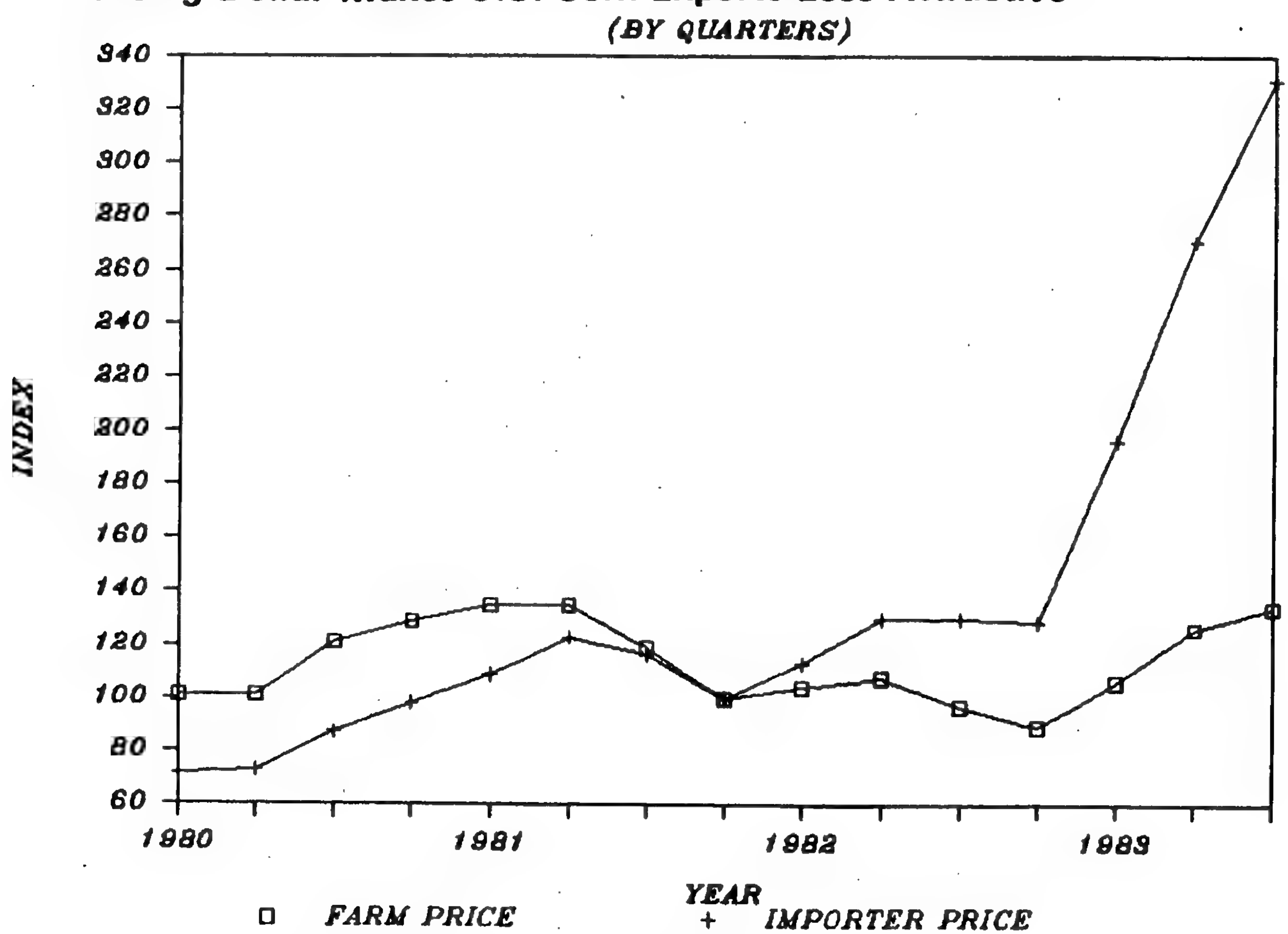
WEAK DEMAND IS A GLOBAL PROBLEM

- Widespread Recessions
- Rising Value of Dollar
- Instability in Eastern Europe, Mexico, elsewhere
- Embargo-Related Losses
- East-West Political Tensions
- Unfair Trade Practices

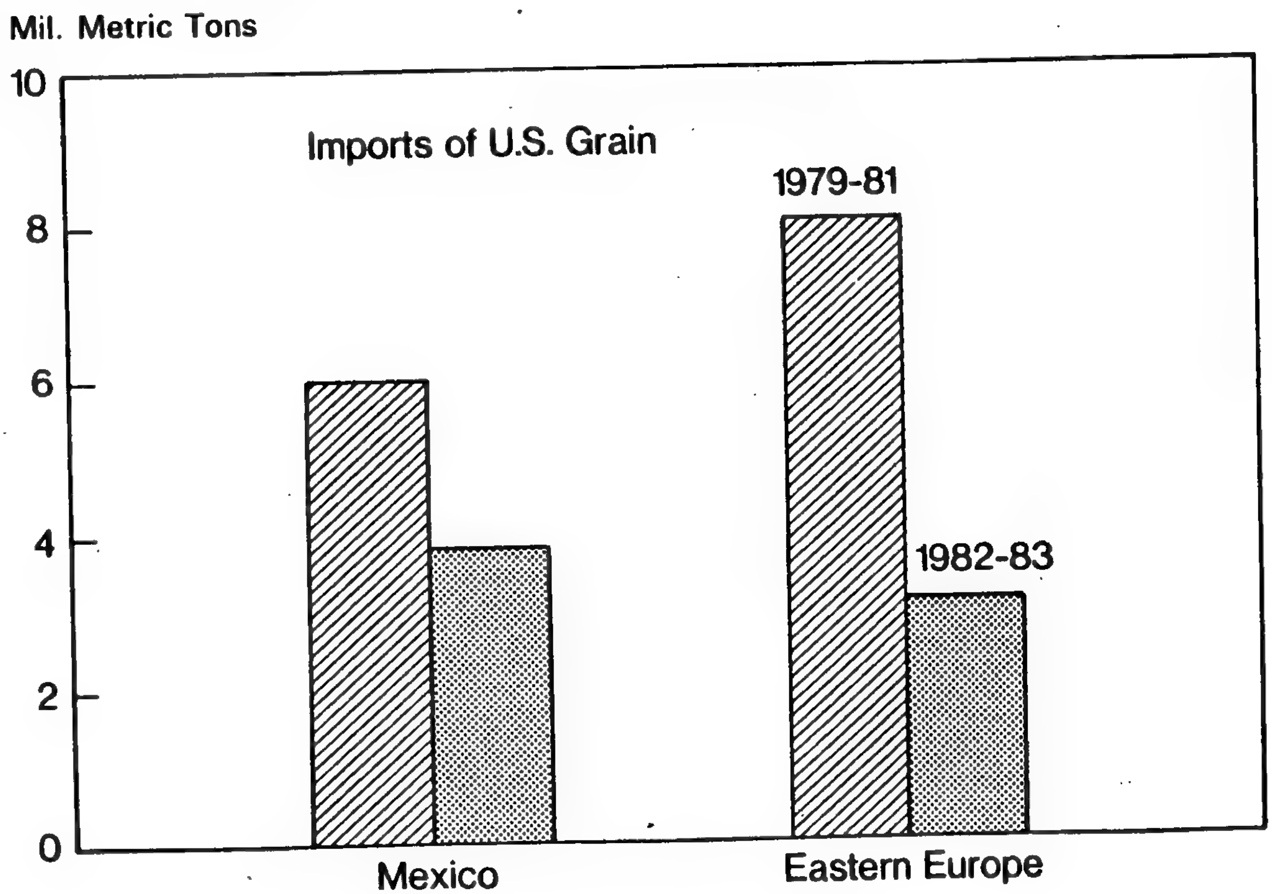
Global Recessions 1978-82



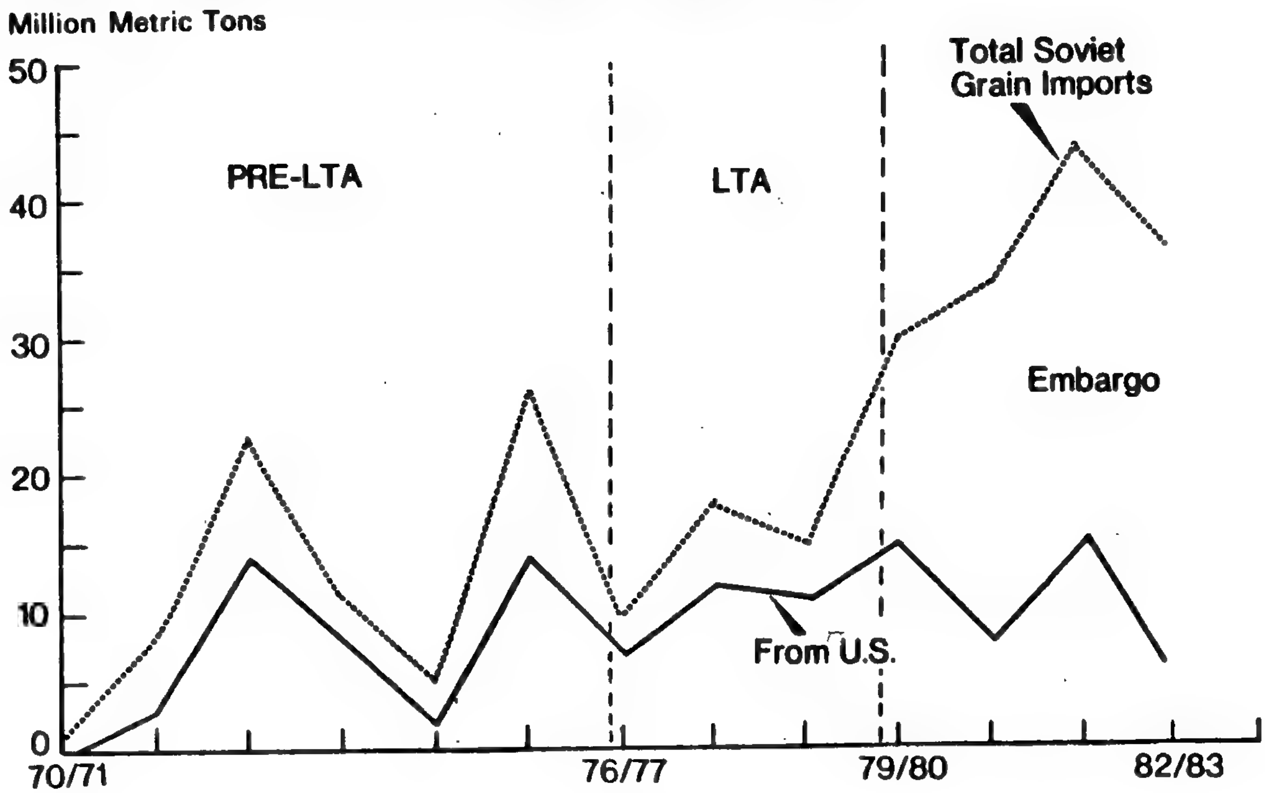
Rising Dollar Makes U.S. Corn Exports Less Attractive



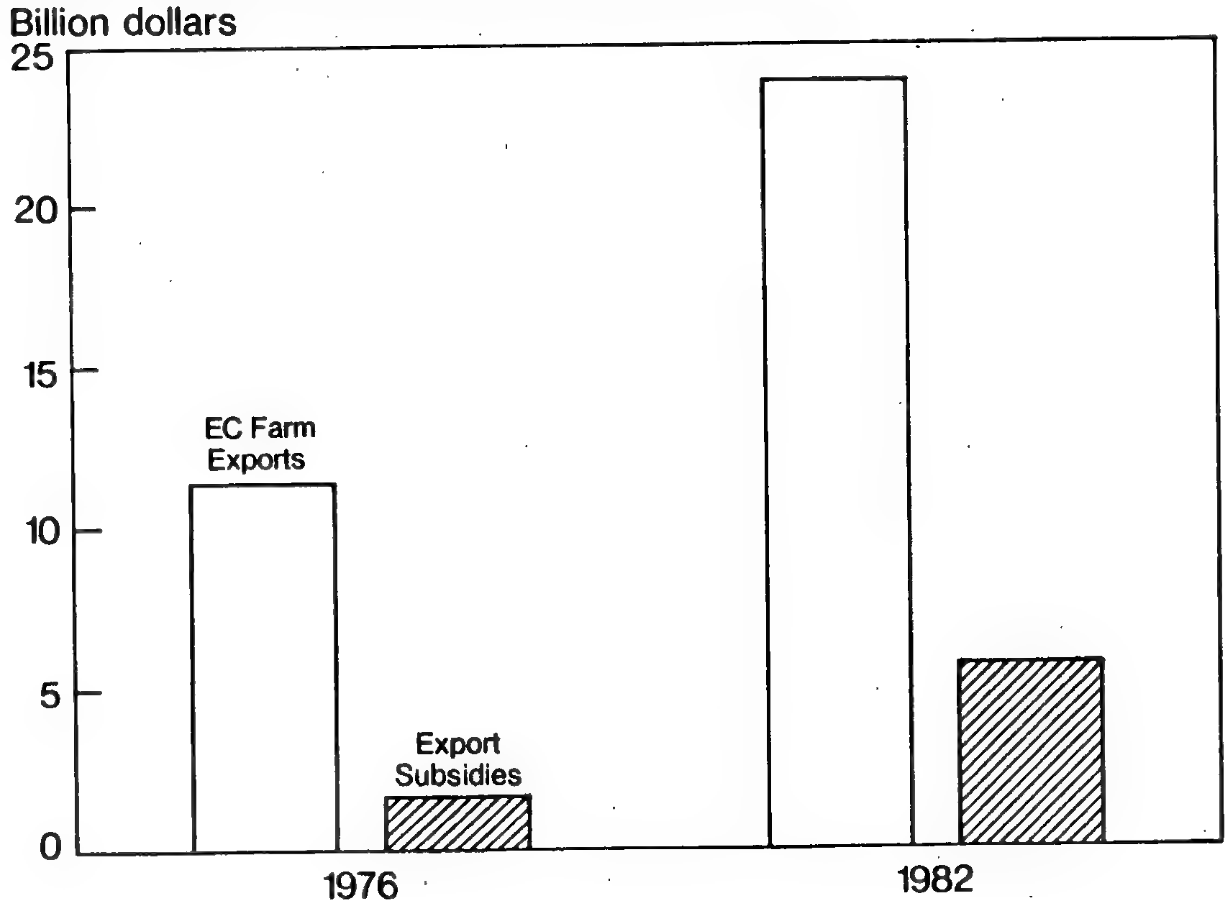
Instability Reduces Farm Exports



Embargo Cut U.S. Share of Soviet Grain Imports



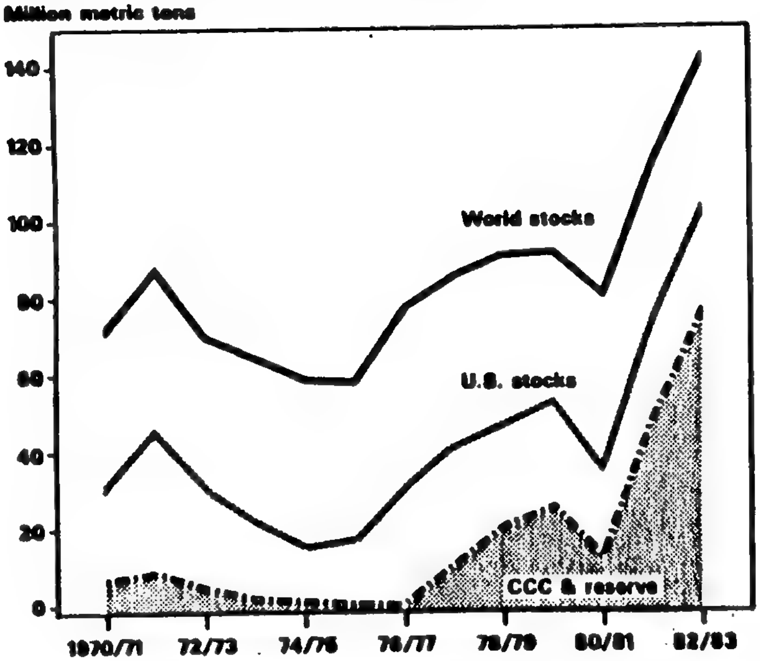
EC Subsidies Expand Their Exports



Soaring Grain Stocks

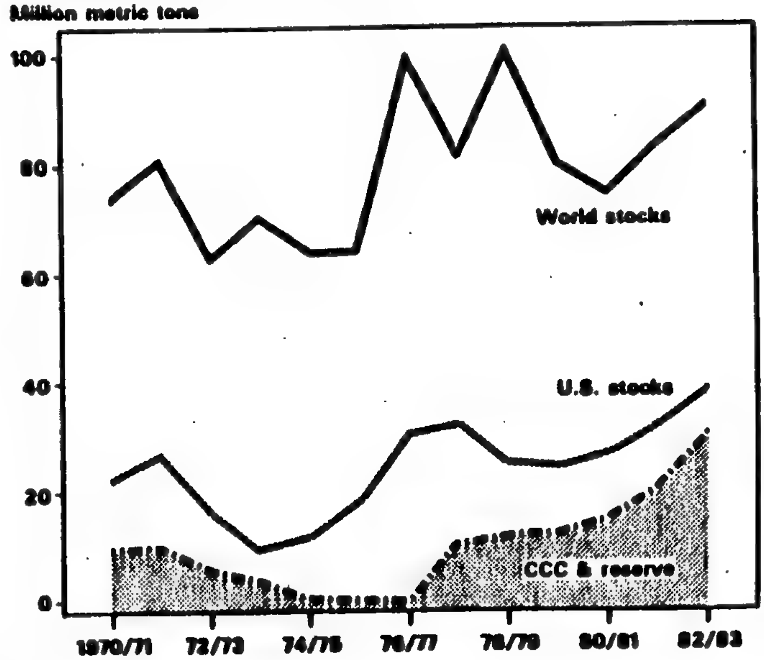
World Coarse Grain Ending Stocks

Million metric tons



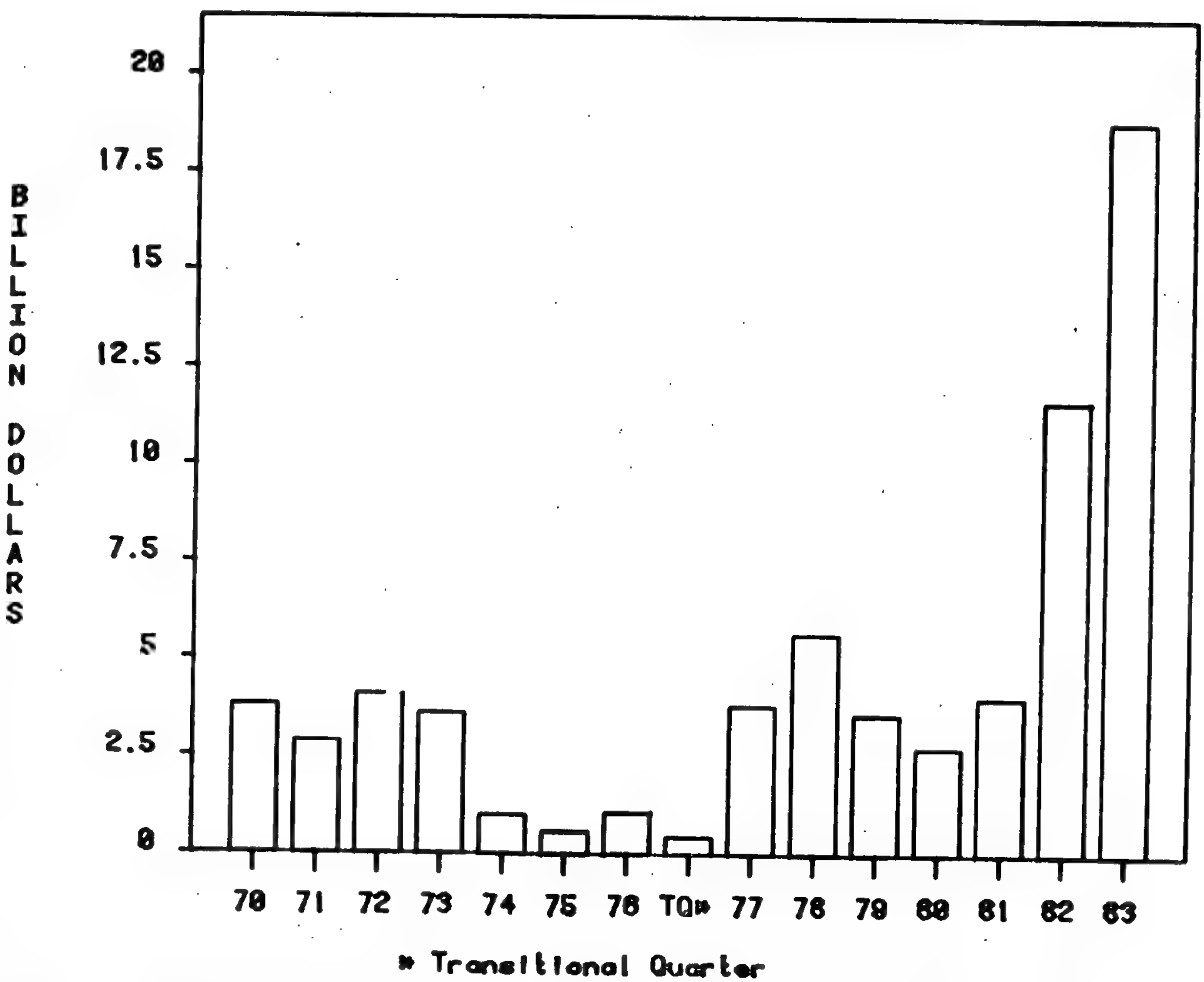
World Wheat Ending Stocks

Million metric tons



October 22, 1982

ROGRAMS HAVE SKYROCKETED

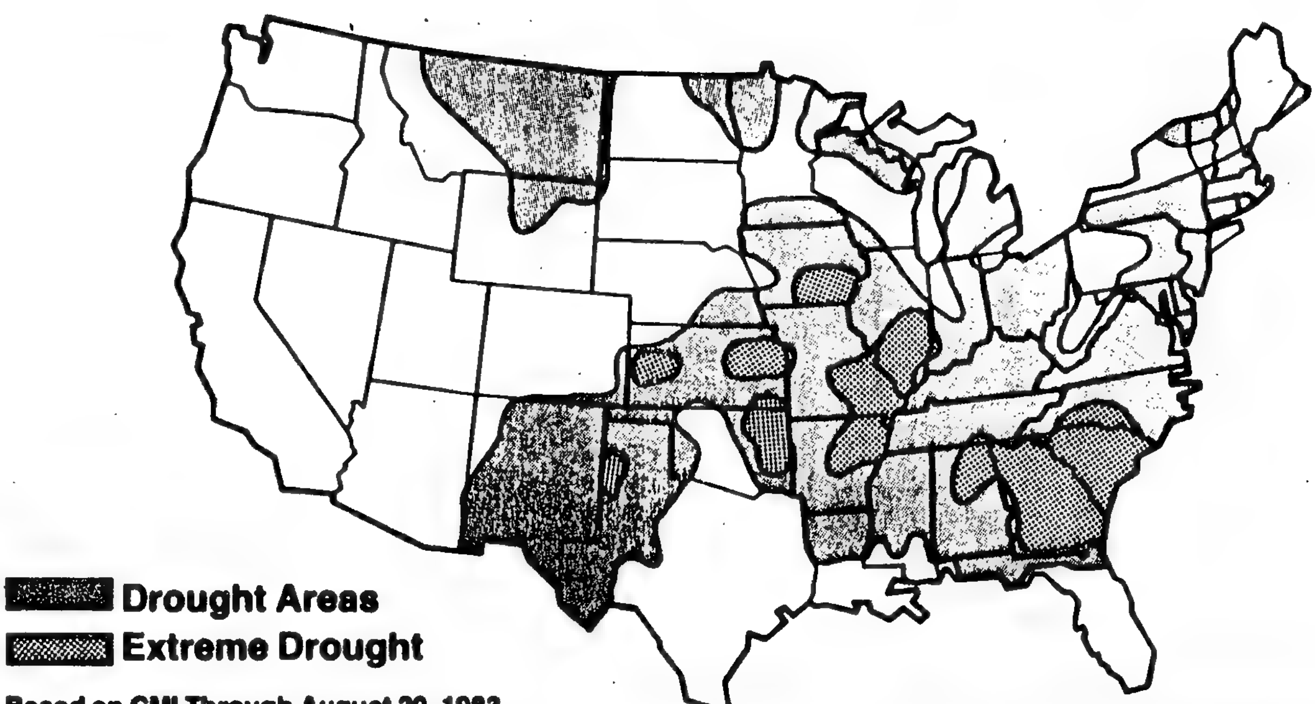


PIK APPEALING FEATURES:

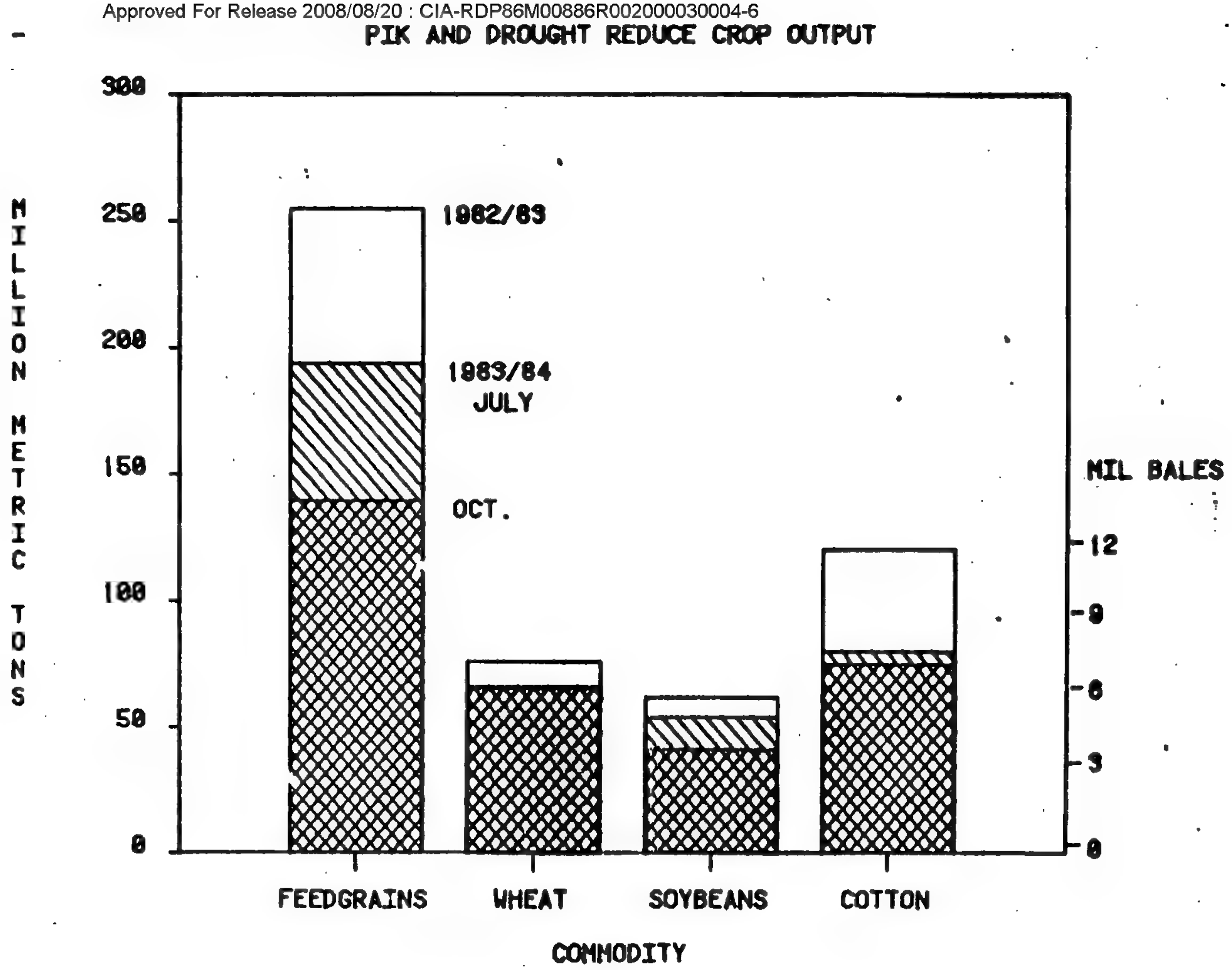
- PRODUCTION WILL BE REDUCED AND SUPPLY WILL BE MORE IN BALANCE WITH DEMAND
- STOCKS AND PRODUCTION CAN BE REDUCED AT THE SAME TIME
- AVAILABILITY OF MARKET SUPPLIES WILL BE MAINTAINED
- GOVERNMENT OUTLAYS FOR DOMESTIC PROGRAMS WILL DECLINE
- THE PROGRAM IS SELF-TERMINATING
- FARMERS WOULD HAVE THE SAME OR GREATER NET RETURNS
- SOUND CONSERVATION PRACTICES APPLIED TO MORE ACREAGE
- STORAGE SPACE PROBLEMS WOULD BE LESSENED

(EXACTLY AS PREPARED FOR PIK PROGRAM, JANUARY, 1983)

States Affected by 1983 Drought



Based on CMI Through August 20, 1983


PIK AND DROUGHT REDUCE CROP OUTPUT
MILLION METRIC TONS
300
250
200
150
100
50
0
1982/83
1983/84
JULY
OCT.
MIL BALES
12
9
6
3
0
FEEDGRAINS
WHEAT
SOYBEANS
COTTON
COMMODITY

FARM PRICE SUPPORT SPENDING

WHO SHOULD GET THE BENEFITS

AND

IN WHAT FORM?

NOT ALL FARMS ARE THE SAME

12% of farms = 2/3 cash receipts
($65,000 + per year)

VS

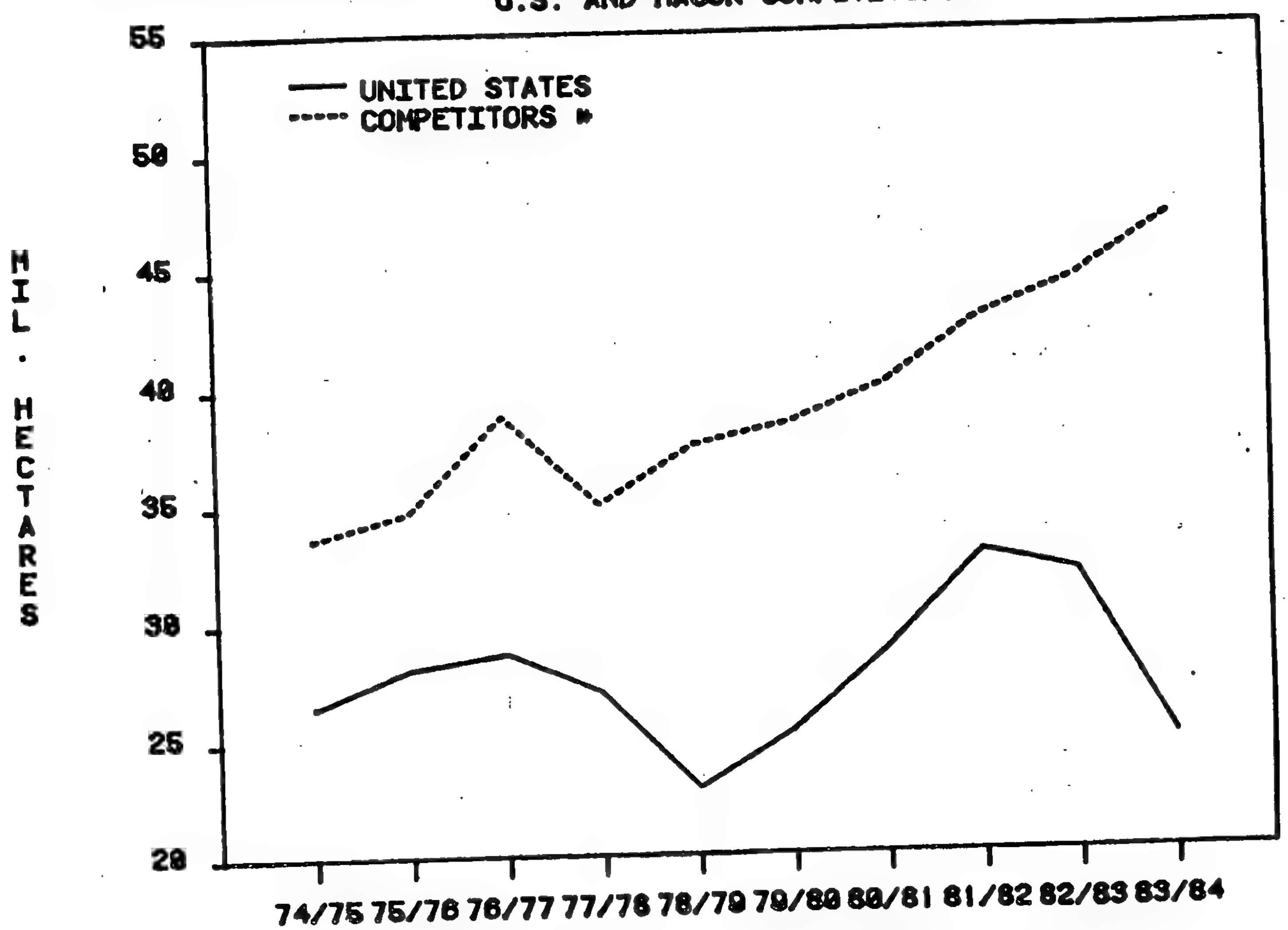
60% of farms = 1/10 cash receipts
(only 1/6 of income)

U.S. COTTON

50 YEARS OF ACREAGE CONTROL
(million bales)

	1930	1983
U.S.	14	7.6
Rest of World	11	59

WHEAT PLANTINGS
U.S. AND MAJOR COMPETITORS



* INCLUDES CANADA, AUST., ARGENTINA, AND EC.

COMMODITY LOANS

IF TOO HIGH:

- **CAN DISTORT MARKET SIGNALS CAUSING EXCESS PRODUCTION WHEN NOT NEEDED (both in U.S. and rest of world)**
- **TRIGGERS EXCESS TREASURY EXPOSURE**

TOTAL CCC NET LENDING FOR COMMODITY LOANS

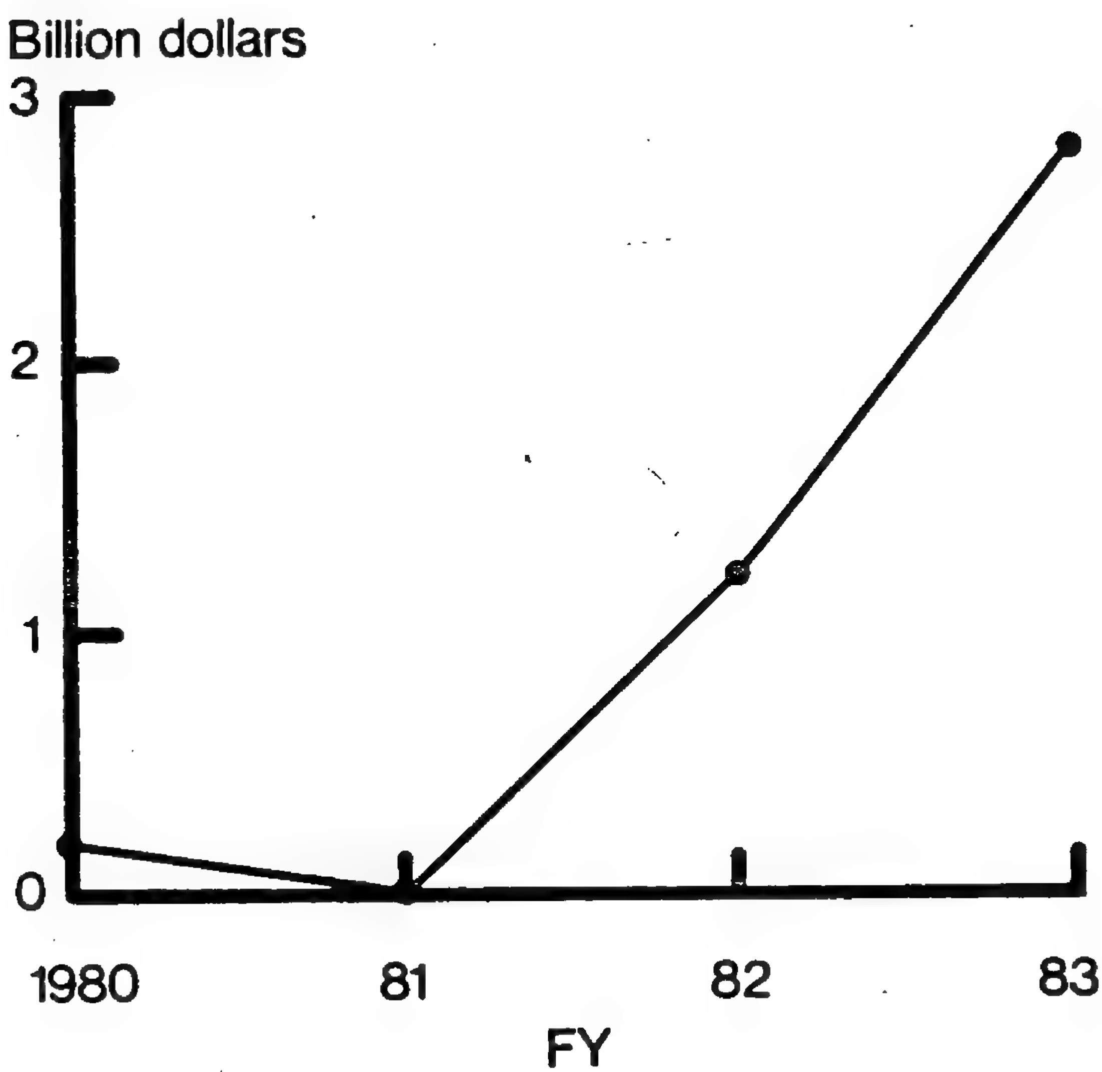
1981 = $ .1 BILLION

1983 = $4.5 BILLION

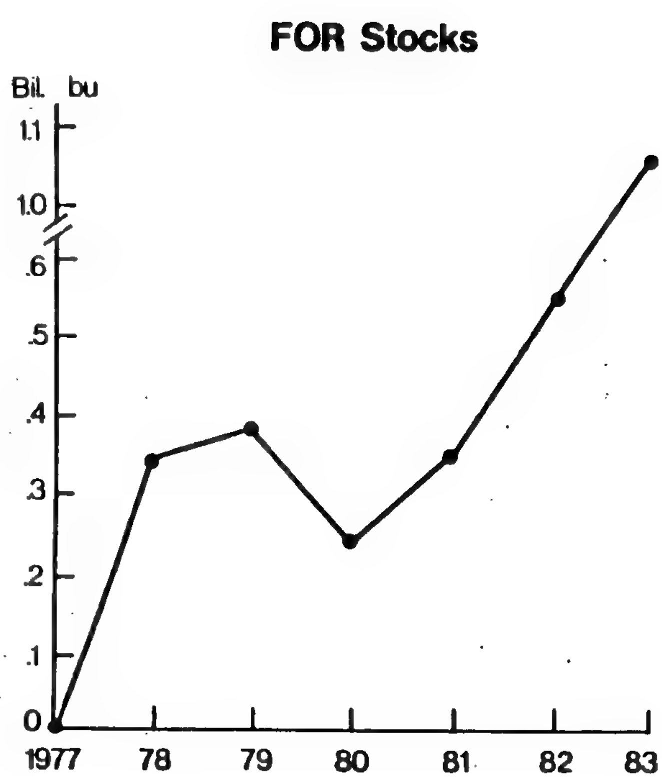
EXCHANGE RATE MOVEMENTS ALTER IMPACT OF CORN LOAN RATE ADJUSTMENTS

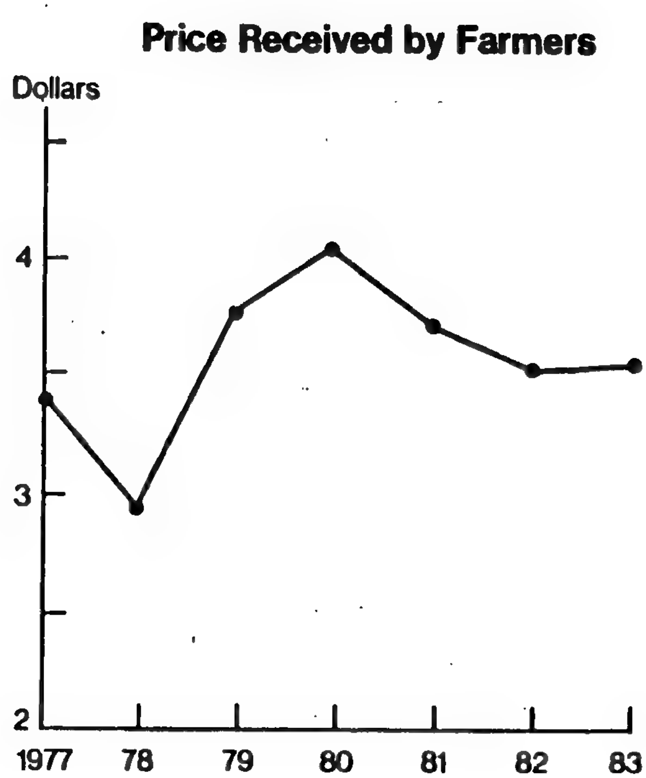
	FROM 1976/77 TO 1980/81	FROM 1980/81 TO 1983/84
• U.S. LOAN RATE IN U.S. DOLLARS	+50%	+18%
ADJUSTED FOR REAL EXCHANGE RATE OF IMPORTERS	+52%	+46%
• U.S. FARM PRICE	+45%	-11%
• U.S. CORN EXPORTS	+40%	-11%

CCC Deficiency Payments
(all eligible crops)



Farmer Owned Reserve (FOR)
Wheat





AGRIGULTURAL TRADE POLICY

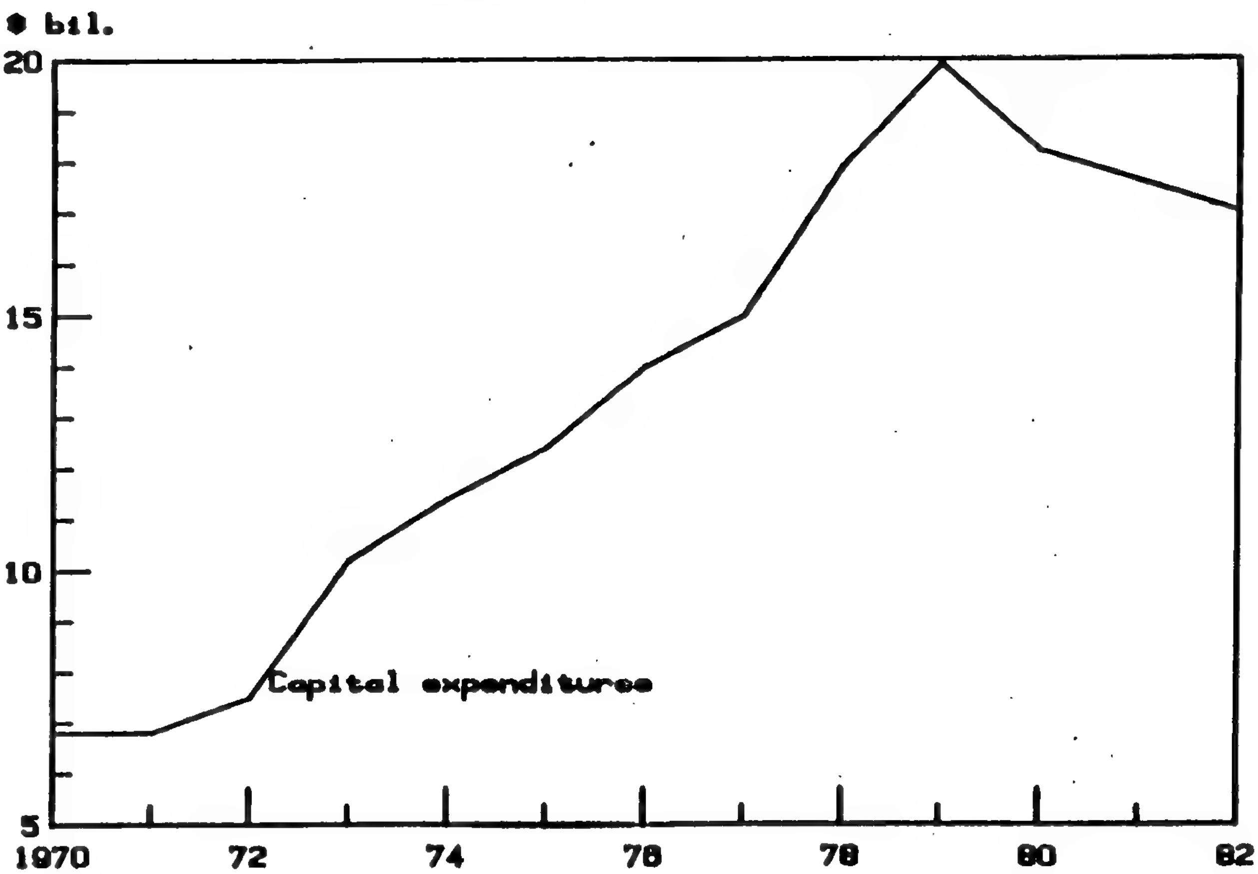
40% OF U.S. CROPLAND PRODUCING FOR WORLD MARKETS

DOMESTIC AND INTERNATIONAL FARM POLICY NOW INSEPARABLE

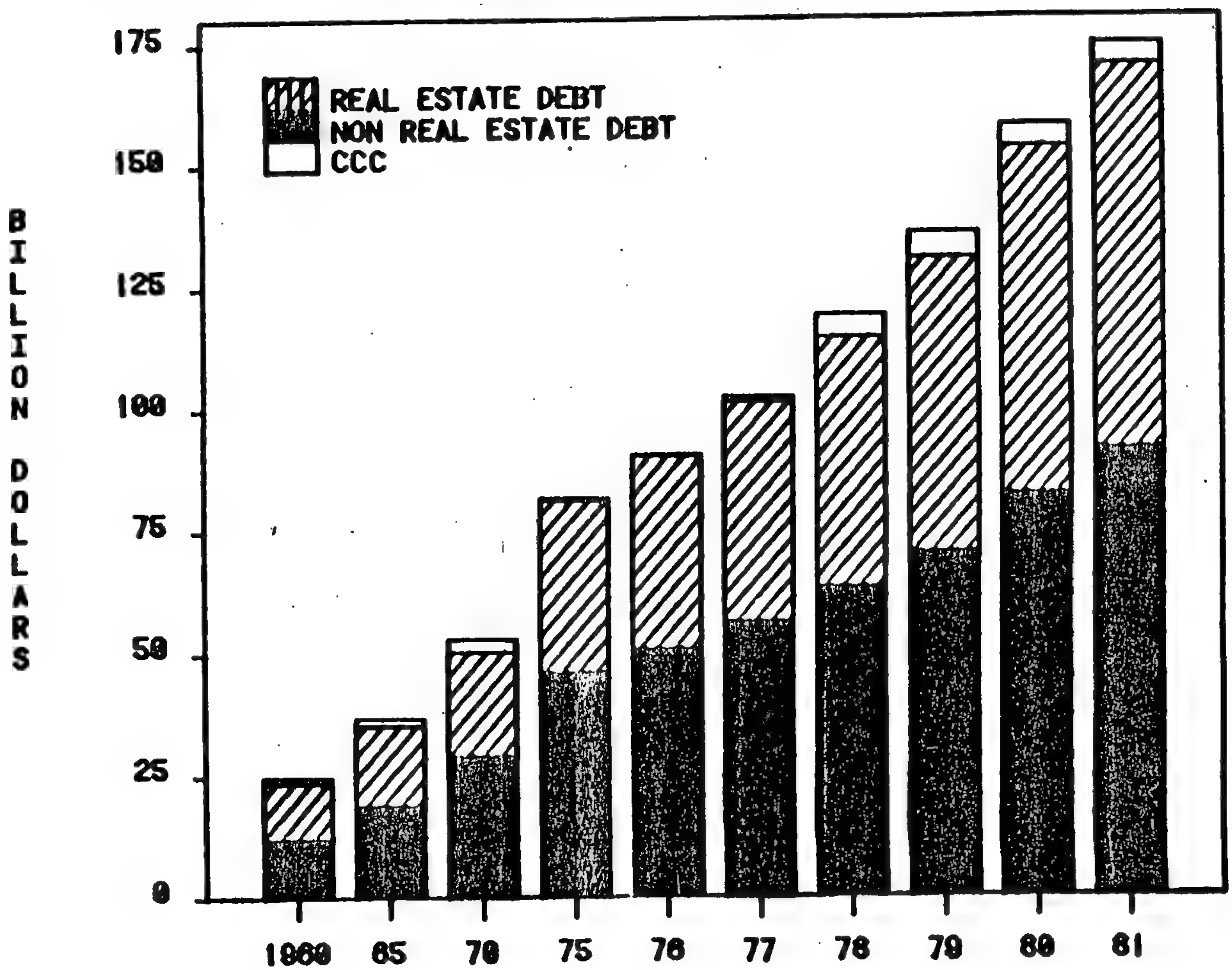
ADMINISTRATION ACCOMPLISHMENTS

- NEW USSR LTA
- NO AGRICULTURAL EMBARGOES
- RECORD EXPORT CREDIT SPENDING
- TARGETED RETALIATION AGAINST UNFAIR SUBSIDIES
- CONTRACT SANCTITY

Capital Investment Was Heavy During 70's



Easy Credit Has Boosted Farm Debt



REDUCING THE DEFICIT

CRITICAL TO RECOVERY

- WEAKER DOLLAR = BOOST IN EXPORTS
- LOWER INTEREST RATES = LOWERED PRODUCTION COSTS AND INCREASED DEMAND

1980 - 1983

WHAT HAVE WE LEARNED?

- FARM POLICY MUST BE FLEXIBLE.
- TRADE POLICY MUST SUPPORT AN EFFICIENT AGRICULTURE.
- RESPONSIBLE FISCAL AND MONETARY POLICY VITAL TO AGRICULTURAL RECOVERY.

THE UNITED STATES TRADE REPRESENTATIVE
WASHINGTON
20506

January 20, 1984

MEMORANDUM TO THE PRESIDENT

FROM: WILLIAM E. BROCK

SUBJECT: Agenda for the Next CCCT Meeting

Two items are on the agenda for the next meeting of the CCCT: The Wine Equity Act of 1983 and Export Subsidies on Poultry and Eggs. Both have been considered by the Trade Policy Committee and I'd like to review for you the disposition of each issue.

The Wine Equity Act

When the Congress reconvenes, it is likely to consider the Wine Equity Act which has 341 co-sponsors in the House and 51 in the Senate. USTR testified against this legislation on behalf of the Administration in November. The TPC unanimously recommends that the Administration maintain its strong opposition to this legislation.

If enacted, you would be required to direct me to negotiate harmonization of U.S. tariff and non-tariff barriers on wine with other nations that export wine. If unsuccessful within 180 days, you would be required to impose import restrictions on wine that are substantially equivalent to those imposed on U.S. wine exports.

There are a number of arguments against this legislation. First, the Administration has consistently opposed legislation mandating bilateral or sectoral reciprocity such as that envisaged by this bill. Second, the bill is protectionist. Although its stated purpose is to expand U.S. wine exports, it would likely result in the restriction of wine imports. About 85 percent of U.S. wine imports come from the European Community (EC). It would be politically impossible for the EC to respond favorably to a U.S. demand for unilateral EC trade concessions as called for by this bill. If the U.S. were then to unilaterally raise its duties on wine, the largest EC agricultural export to the U.S., the EC could invoke its GATT rights and retaliate against U.S. exports.

Third, it would cause us to be in violation of GATT Article I which states that the same tariff level must be imposed on imports from all other member countries. Fourth, it would probably result in unraveling the recently concluded U.S.-EC regulatory accord, thereby closing the EC market to now established U.S. wines. Fifth, it would cause higher prices for U.S. wine consumers and reduce consumer choice in the marketplace.

In cases where the U.S. wine industry has legitimate problems in gaining entry to foreign markets, we have been working to assist them. The recent regulatory accord negotiated between the U.S. and EC is one example. As another, we have asked the Japanese Government to consider unilaterally reducing their duty on wine. Also, if USTR were authorized by the Congress to negotiate tariff reductions, a power we do not now have, we would include lowering tariffs on wine as a negotiating objective. If in reality the U.S. wine industry is concerned about its increasingly uncompetitive position in the domestic market, as compared to foreign wines, this legislation is not an appropriate way to address such concerns.

Export Subsidies on Poultry and Eggs

On July 18, Senator Mattingly and 70 of his Senate colleagues sent you a letter requesting export subsidies for U.S. poultry and eggs as a means to counteract unfair EC and Brazilian subsidies and to regain overseas markets for U.S. exporters. In response to Senator Mattingly's request, USDA proposed that we give Egypt and Iraq sufficient quantities of surplus U.S. dairy stocks to make it attractive for them to buy poultry commercially from the United States.

In presenting the proposal to the TPC on October 25, USDA Deputy Secretary Lyng noted that it was time to consider another subsidized sale in order to refocus the European Community's attention on the need to discipline export subsidies on agricultural products. He felt the modest sale of 50,000 tons of poultry would be beneficial to the bilateral discussions on subsidies and would be welcomed by the U.S. poultry industry whose sales to the Middle East market had fallen from 80,000 tons to 0 in the past 2 years.

The USDA proposal was not approved by the TPC. The representative from the Council of Economic Advisers felt that poultry was an inappropriate commodity to subsidize. Sales to Egypt and Iraq would leave the EC relatively unscathed because Brazil is the dominant supplier. The export of non-fat dry milk would

hurt the Dutch, who have supported our efforts to avert restrictions on our exports of grain substitutes into the EC. If we took dairy markets away from them, we might lose their support.

OMB Director Stockman felt the proposal was too costly. He argued that we would be giving away non-fat dry milk with a value of $100 million to create a $30 million subsidy for Egypt which is already receiving $2 billion in U.S. aid. If implemented, the proposal would result in a 1 percent increase in U.S. chicken prices.

The purpose of the next CCCT meeting is to revisit Senator Mattingly's proposal. Unfortunately, because of recent increases in U.S. poultry prices and a decline in the world price of non-fat dry milk, we would have to give away a larger quantity of non-fat dry milk to complete this transaction.

WINE EQUITY ACT

Issue

Should the Administration support the Wine Equity Act of 1983.

Recommendation

The Wine Equity Act was reviewed by the Trade Policy Review Group (TPRG) and there was unanimous agreement among the agencies represented for opposition.

Description of Act

The Wine Equity Act of 1983 (H.R. 3795/S.2182) would mandate the President to direct the USTR to negotiate harmonization of U.S. tariff and non-tariff barriers on wine with other nations that export wine. USTR would have 180 days to negotiate foreign barriers to U.S. wine equal to those in the United States against foreign wines. If this were not achieved, the President would be required to impose tariffs and non-tariff barriers on wine imported into the U.S. equal or substantially equivalent to those imposed by the country of origin. (The U.S. tariff on still wines is 37.5 cents per gallon compared to 67-80 cents per gallon for the European Community using 1981 exchange rates. At present exchange rates, the EC duty is 33-51 cents per gallon.)

Congressional Action

H.R. 3795 was introduced on August 4, 1983 and has 338 cosponsors. The companion bill was introduced on November 18 in the Senate with 50 cosponsors. Sponsorship in the house is two to one Democratic, with over 100 Republican cosponsors. Sponsorship of the Senate bill is bipartisan with 29 Republicans and 21 Democrats.

Hearings were held on H.R. 3795 on November 15, 1983 by the Subcommittee on Trade of the House Committee on Ways and Means. USTR (representing the views of OMB and the Departments of State, Treasury, Agriculture, Commerce and Labor) testified against the legislation, which was supported by the domestic wine and grape industry but opposed by the National Association of Beverage Importers.

During the hearing, Chairman Gibbons asked that the Administration work with the sponsors of the legislation to make the bill acceptable.

The Domestic Wine Industry

After having doubled over the past decade, growth in the U.S. market for ordinary and quality table wines is slowing. In 1982, the domestic market expanded by 2.6 percent following annual growth rates of 7 to 15 percent over the past ten years. This is having

an adverse effect on the domestic wine industry while imported wines continue to capture a large and growing share of the U.S. market. Inventories of domestic wines increased substantially the past two years and growers' prices sharply declined. The 1982 average grower price of grapes crushed for wine dropped almost 25 percent from the previous year and prices declined further in 1983. Additionally, fewer Thompson seedless grapes are being purchased by wineries, resulting in more being forced onto an already oversupplied raisin market. While suffering through a severe economic period, the domestic industry does not want to lose more of the domestic market to imports, especially those from Europe.

Close to one-third of the growth in the U.S. market over the past decade has been filled by imported wines. The market share for imports rose from 19 percent in the early 1970's to a high of 26.5 percent in 1982. According to USDA's Wine Subsidy Task Force, the slowing rate of expansion in the U.S. market has not significantly affected imports. In 1982, the import volume rose by 7 percent and in the first seven months of 1983, imports were up 12 percent. Italian wines accounted for 85 percent of the growth in U.S. imports. Italy's import share has risen from less than 25 percent in 1975 to more than 60 percent in 1982. France is the second largest supplier but France's share of the import market has remained at 17 percent. The following table provides some trade data:

1982 U.S. Wine Imports

Source	Champagne and Sparkling Wines (TSUS 167.10)	Still Wines (TSUS 167.30)
	------millions of U.S.	dollars------
World	130	585
EC	117	529
France	66	189
Italy	46	239
Germany	3	99

Reduction of Barriers to Trade in Wine

For a number of years, the U.S. wine industry has been requesting the USG to negotiate the reduction of barriers to U.S. wine exports. The severity of the domestic situation has caused the industry to reiterate their concerns and support legislation such as the Wine Equity Act, and to initiate countervailing duty and antidumping proceedings against French and Italian wine imports.

During the past few years, the USG has made a number of efforts to identify and reduce foreign barriers to U.S. alcoholic beverage exports, as is already required by Section 854 of the Trade Agreements Act of 1979. In December 1981, the President submitted

a comprehensive report to the Congress identifying foreign barriers to U.S. wine exports as well as foreign market potential for these exports. The report generally concluded that in many cases a reduction of foreign obstacles could lead to an increase in U.S. exports of alcoholic beverages. It also concluded that increased industry marketing efforts are necessary to increase foreign sales.

Recent USG efforts to increase foreign market access for U.S. wine exports have been hampered by the lack of tariff negotiating authority. Nonetheless, USG offices have actively pursued our legislative mandate. Japan has been requested to reduce its high tariff on U.S. wines (55 percent ad valorem) and to simplify its two-tiered internal wine tax system, as well as to provide concessions on other alcoholic beverages. Ambassadors Brock and Smith have personally raised this issue at the highest levels of the Japanese Government in the context of overall discussions to improve Japanese market access for U.S. products. A small step was taken in September, 1983, when Japan agreed to accept U.S. certificates of conformity to Japanese wine product standards.

With regard to the EC, in July 1983, the Administration finalized an important accord with them on regulatory barriers to wine trade. The accord substantially harmonizes the technical aspects of U.S. and EC wine making practices, thereby ensuring U.S. wines access to the EC market. Prior to this accord, the EC provided a temporary derogation from its regulatory requirements for U.S. wines pending the outcome of bilateral discussions. During this time, several U.S. wine producers were successful in establishing markets for their products in EC countries, particularly the United Kingdom. In addition, it is anticipated that the EC will shortly agree to cease imposing countervailing charges on imports of wine from the United States.

Administration Position

The Administration has opposed this legislation for the following reasons:

The bill's stated purpose is to expand U.S. wine exports, but its likely effect will be the restriction of U.S. wine imports. H.R. 3795 will not help the USG make progress in reducing foreign barriers. From past consultations with the industry, it has been determined that the best potential foreign markets for U.S. wines are Japan, Canada, and the non-wine producing countries of the EC. Retaliatory action under Section 4(b) of H.R. 3795 would have little or no impact on Japan and Canada since they export virtually no wine to the United States. Such action provides them no incentive to improve market access for U.S. wines. In the case of the EC, which accounts for about 85 percent of U.S. wine imports, the bill sets conditions that would be politically difficult, if not impossible, for the EC to meet. The EC would be unlikely to respond favorably to a U.S. demand for unilateral EC trade concessions, which are called for by H.R. 3795, since

we do not have authority to negotiate on tariffs. Consequently, we would be required by law to retaliate against the EC.

Increasing U.S. barriers to wine imports has a number of implications. First, as the result of past trade negotiations, the United States has agreed to maintain its current tariff levels for wine in return for reciprocal concessions of benefit to other products the U.S. exports. These commitments were made long before the U.S. wine industry had matured to its present stage. The first U.S. duty concession on wine goes back to a 1936 agreement with France. If the United States were to unilaterally raise its duties for wine, the largest EC agricultural export to the United States, the EC could invoke its GATT rights and retaliate against U.S. exports of other products, such as corn gluten feed and soybeans. Administration officials have already linked wine and corn gluten feed in discussions with the EC. Second, Section 4(b) of H.R. 3795 requires the President to impose different tariff and non-tariff barriers on wine imports from different sources, which is a violation of U.S. obligations under GATT Article I. Third, retaliatory action against the EC under H.R. 3795 could unravel the recently concluded regulatory accord, thereby closing the EC market to now established U.S. wine products. Fourth, an increase in U.S. import barriers would result in higher prices for U.S. wine consumers and would reduce consumer choice in the marketplace. Fifth, it would be very difficult for the Customs Service to administer a system that applies different barriers to imports from various sources.

The Administration has consistently opposed legislation mandating bilateral or sectoral reciprocity such as that envisaged by this bill. If the principle of sectoral reciprocity were to become a guiding principle in international trade and trading nations aimed at balancing benefits on a sectoral basis, the result would be to restrict trade, rather than expand it, particularly if importing countries adopted differential treatment depending on the source of imports.

During the hearings on the bill, USTR officials noted that the United States has traditionally followed a policy of overall reciprocity in negotiating reductions to barriers to international trade and therefore supports in principle H.R. 1571, the Reciprocal Trade and Investment Act of 1983. This is a general reciprocity bill, which includes a provision granting the Executive Branch tariff negotiating authority. If H.R. 1571 were passed by the Congress, the Administration could use part of this authority to try to liberalize foreign barriers to U.S. alcoholic beverage exports.

Poultry Export Proposal

Proposal Summary

USDA proposes to give U.S. poultry exporters sufficient quantities of CCC surplus non-fat dry milk (NDM) for export to enable them to sell 50,000 MT of whole broilers in the Middle East/North Africa region over a 12 month period. The NDM will be exported at world marekt prices and the proceeds from these sales will allow U.S. poultry exporters to compete against subsidized competition from the EC and Brazil.

U.S. exporters of whole broilers are now facing a $700-850 per metric ton price disadvantage in several key Middle East and North African markets compared to subsidized sales being made by the European Community and Brazil. 1/ U.S. whole broiler exports to the Middle East and North Africa fell from a record 87,000 MT in 1981 to only 750 MT in 1983. The forecast for 1984 is just as dismal.

This action will have very little real economic impact on either the U.S. poultry industry or the EC. It will, however, have a significant psychological impact on the EC and a very favorable political impact with the U.S. poultry industry.

Proposal

In lieu of a direct cash subsidy, surplus CCC stocks of non-fat dry milk could be used to compensate U.S. poultry exporters for the price differential they face in the Middle East. Specific quantities of NDM for export only could be given to poultry exporters based on the quantity of whole broilers exported to countries in the Middle East. The exact quantity of NDM made available would be determined on a bid basis with the exporter basing his bid on world market prices for NDM and the differential between U.S. and subsidized foreign poultry export prices in the Middle East. For example, a poultry exporter facing a $750 price disadvantage might ask for one ton of NDM (for export) for each 1.0 MT of poultry exported based on the current world NDM price of $750/mt. The exact quantity of NDM needed will be determined on a bid basis.

1/ See Attachment 1 for comparison of U.S. and Brazilian prices.

The proceeds from the dairy export sales would be used to compensate the poultry exporter for the current differential he faces on whole broilers in the Middle East.

Restrictions would be placed both on the export destination of the NDM and the whole broilers. In both cases, the destination would be limited to non-communist countries in the Middle East/North Africa region. Poultry sales would be limited to the Middle East because this is where we are facing the most serious problems with subsidized competition from Brazil and the European Community. Dairy sales would be limited to the Middle East to minimize the impact on non-subsidizing supplying countries, i.e. New Zealand. Imported dairy products in this region are supplied principally by EC member countries. To sell 50,000 MT of whole broilers in the Middle East at competitive prices (to meet subsidized competition) may require approximately 50,000 MT of NDM.

Background

The Middle East and North Africa region is the largest market for whole broilers in the world and has traditionally been the largest market for U.S. whole broiler exports. Imports of frozen broilers in 1984 are projected at 800,000 MT. Saudi Arabia (245), Iraq (50), Iran (120), Kuwait (50) and Egypt (75) are the principal markets for whole broilers in the Middle East. Figures in parentheses are FAS estimates of 1984 imports in thousands of metric tons.

Impact on World Dairy Markets

The impact of exporting 50,000 MT of NDM on world markets would be minimal in most marketing years with this quantity accounting for approximately 5 percent of world exports. The current world market for most dairy products, however, is quite weak. Burdensome stocks of NDM and butter in the European Community and in the U.S. plus lagging consumer demand worldwide have depressed world prices from the relatively favorable levels of 1981. The following table shows market price levels f.o.b. most European ports, along with the GATT minimum levels:

	1981 Price	Current Price	GATT Minimum
		Dollars/MT	
NDM	1,050-1,100	750	600

United Nations trade data show that approximately 2.3 million MT of dry milk and cream were imported on a world basis in 1981 (most recent data available) with approximately 330 thousand mt or 14 percent going to the Middle East and North Africa.

The European Community is the principal supplier to the Middle East/North African markets. Restricting NDM exports to the Middle East and North Africa should minimize the disruption to other world markets supplied by New Zealand, but could still have a negative impact on dairy prices, possibly pushing NDM prices to the GATT minimum.

Impact on Domestic Poultry Market

Fifty thousand tons of whole broilers would amount to approximately .8 percent of total U.S. broiler production. ERS analysts estimate the broiler industry can normally accomodate a production growth rate of 4 percent over a one year period without difficulty. Industry sources have advised that U.S. production facilities could easily gear up to produce broilers to meet Arabic specifications if sales are forthcoming. The production of 50,000 MT of whole broilers for export over a one-year period would have little or no impact on domestic broiler prices or domestic availabilities. They would help to recapture a significant portion of the Middle East broiler market lost since 1981.

Method

USDA would issue invitations to bid on a bi-monthly basis to private traders for specific quantities of NDM (delivered FAS U.S. port) for export use only. Bids would be based on the quantity of NDM required to compensate U.S. whole broiler exporters for the price differential (approx. $700 - 850/MT) they now face in the Middle East. USDA would review these bids and accept the lowest bids needed to export 10,000 MT of poultry during a two month period. Sales of both whole broilers and dairy products under this program would be restricted to the Middle East/North Africa region. Proof of export would be required for both the poultry and dairy sales.

Pros

* Enable U.S. poultry exporters to recapture part of loss to subsidized competition in the Middle East.

* Further demonstrate to agricultural constituency that Administration is committed to fighting harmful trade practices.

* Continue to keep EC off balance about U.S. intentions.

* Reduce stocks of surplus dairy products, and result in savings in storage and interest charges.

* Would require no new budgetary outlays by USG.

Cons

* New Zealand and possibly Canada will react unfavorably to sale of NDM and argue indirect damage to their dairy industries.

* Could be a spillover effect on other US-EC bilateral issues.

* Could stimulate others to seek similar arrangements using dairy products.

Additional Comments

This proposal would have very little real economic impact on either the U.S. broiler industry or the EC. It would, however, have a significant psychological impact on the EC and a very favorable political impact with the U.S. poultry industry. Sales of 50,000 tons of whole broilers over a 12 month period would mean an additional $85 million in foreign exchange earnings for the U.S. This is approximately the value of lost sales to the Middle EAst from 1981 to 1982.

This proposal requires no new costs to the Government. The estimated 50,000 MT of surplus NDM needed for this proposal are now in government stocks. Storage alone of this quantity of NDM costs almost $1 million annually. However, there would be an accounting loss to the CCC.

Comparison of U.S., French and Brazilian Export Prices for Whole Broilers, C&F Middle East Port

U.S. wholesale price (Jan. 1984) (.60/lb.) 1/	$1,325/mt
Arabic pack and labelling ($.08/lb.)	176/mt
Port handling charges (receiving, warehousing, loading)	40/mt
Freight to Middle East port	160/mt
U.S. C&F (free out) price	$1,700/mt
Current C&F Middle East Quotes 2/	$850-1000/mt
Total Subsidy Required	$700-850/mt

1/ The current U.S. 12-city average wholesale price is $.60/lb. or approximately $1,325/mt. The Economic Reseach Service forecasts strong domestic wholesale prices through the year as declining red meat supplies (compared to 1983) help hold broiler prices up, even with higher broiler output.

2/ Middle East quotes based on recent Egyptian public tenders and trade reports.